BEYOND GIFTING: HARMONIZING THE DEVOLUTION OF REORGANIZATION PLAN GIFTS AND THE EVOLUTION OF SALE GIFTS

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TABLE OF CONTENTS

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INTRODUCTION

Chapter 11 of the Bankruptcy Code[1] is a readily accepted business tool pursuant to which corporations seek to restructure their debts by redeploying scarce assets[2] in satisfaction of their liabilities. When a company's liabilities far exceed asset value, how to structure a plan of reorganization presents a vexing issue that plagues the boardroom.[3] Directors of insolvent[4] companies owe fiduciary duties to the corporation to maximize the size of the proverbial pie.[5] As such, the directors, required to take action in the best interests of the corporate estate,[6] must account for not only the interests of secured creditors—who have senior claims on assets pledged as collateral—but also for the interests of vendors, employees, customers, and other unsecured claimants.[7] Many of the balance sheets of large insolvent corporations, however, riddled with debt that is secured by substantially all of the corporation's assets, leave little to no value for unsecured creditors.[8] As a

1 11 U.S.C. §§ 101–1532 (2012).

2 Amy Timm, Note, *The Gift That Gives Too Much: Invalidating a Gifting Exception to the Absolute Priority Rule*, 2013 U. ILL. L. REV. 1649.

3 And their lawyers and other advisors.

4 *See* 11 U.S.C. § 101(32) (insolvent is the "financial condition such that the sum of such entity's debts is greater than all of such entity's property").

5 N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 103 (Del. 2007) ("[T]hose directors' duty to maximize the value of the insolvent corporation for the benefit of all those having an interest in it . . . . ").

6 H.R. REP. NO. 95-595, at 220 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6179 ("The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that [the enterprise] may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. The premise of a business reorganization is that assets . . . are more valuable [if deployed in industry than those dismantled and] sold for scrap.").

7 *Id.*

8 Charles W. Mooney, Jr., *The (Il)legitimacy of Bankruptcies for the Benefit of Secured Creditors*, 2015 U. ILL. L. REV. 735 (bemoaning that Chapter 11 has become nothing but a venue for secured creditor's benefit and questioning whether it would be better to force secured creditors to go to state court to foreclose); *see also* H.R. REP. No. 95-595, at 220, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6179 ("Often, the return on assets that a business can produce is inadequate to compensate those who have invested in the business. Cash flow problems may develop, and require creditors of the business, both trade creditors and [funded debt] lenders, to wait for payment of their claims.").

result, the corporate debtor[9] struggles with the optimal balancing between the goals of Chapter 11[10] and the realities of overleverage.[11]

One of the fundamental tenets underlying corporate restructurings is rigid adherence to the payment hierarchy.[12] This waterfall, which dictates the order of payment in Chapter 11 proceedings, is known as the Absolute Priority Rule (APR), and has attained "unassailable, near scriptural status."[13] The APR provides, in simple terms, that to confirm a plan of reorganization such plan must provide secured creditors with the full value of the collateral pledged to secure their claims.[14] In addition, the APR provides that administrative expense creditors (e.g., professionals working for the estate, trade vendors who provide credit support by providing goods and services) must be satisfied in full before unsecured creditors, and unsecured creditors satisfied before equity holders (e.g., shareholders).[15]

In addition, Chapter 11 requires, among other things, votes from holders of impaired claims against the debtor's estate in order to confirm a plan of reorganization.[16] In order to obtain confirmation, a debtor must have the affirmative vote (two-thirds in dollar amount and fifty percent in number)[17] from either all impaired classes of claims or at least one impaired class of creditors.[18] When a single class of creditors votes against the reorganization plan (provided there is at least one impaired accepting class of creditors), the Bankruptcy Code establishes

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9 11 U.S.C. § 101(13); *see Debtor*, INVESTOPEDIA, http://www.investopedia.com/terms/d/debtor.asp (last visited Feb. 13, 2017) ("A debtor is a company or individual who owes money. . . . Legally, someone who files a voluntary petition to declare bankruptcy is also considered a debtor.").

10 H.R. REP. NO. 95-595, at 220, *reprinted in* 1978 U.S.C.C.A.N. 5963; *see also* Toibb v. Radloff, 501 U.S. 157, 163 (1991) ("[W]e agree, that Chapter 11 also embodies the general Code policy of maximizing value of the bankruptcy estate.").

11 *See Overleveraged*, INVESTOPEDIA, http://www.investopedia.com/terms/o/overleveraged.asp (last visited Sept. 4, 2017) ("Occurs when a business has borrowed too much debt, and is unable to pay interest payments on the debts. Companies that borrow too much and are overleveraged are at the risk of becoming bankrupt if their business does poorly."); *see also* 11 U.S.C. § 101(32) (defining insolvent).

12 *See* 11 U.S.C. §§ 725, 726, 1129(a)(7), 1129(b)(2). Section 1129(b)(2) only outlines a payment hierarchy when a class of creditors votes no. In addition, class voting can override § 1129(b)(2) payment hierarchy but class voting cannot override the hierarchy of 1129(a)(7). *See* §§ 1129(a)(7), 1129(b)(2); *see also infra* text accompanying notes 14–15 (outlining the payment hierarchy order).

13 Stephen J. Lubben, *The Overstated Absolute Priority Rule*, 21 FORDHAM J. CORP. & FIN. L. 581, 581 (2016); *see also* Mark J. Roe & Frederick Tung, *Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors' Bargain*, 99 VA. L. REV. 1235, 1236 (2013) ("Priority is . . . quite appropriately, bankruptcy's most important and famous rule.").

14 11 U.S.C. § 1129(b)(2)(A).

15 11 U.S.C. § 1129(b)(2)(B)(ii) ("[T]he holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property. . . .").

16 11 U.S.C. § 1126.

17 11 U.S.C. § 1126(c).

18 11 U.S.C. §§ 1129(a)(8), 1129(b)(1).

a mechanism by which a plan proponent can achieve confirmation over the dissent. Such a path is referred to as "cram down."[19] Although the Bankruptcy Code envisions such a path, cram down is typically expensive, time-consuming, and without a predictable outcome.[20] Hence, most debtors prefer less risk in the confirmation process.[21] As a result, creative debtors and their supporters (creditors who like the proposed Chapter 11 plan) have attempted to redirect part of their plan distributions to junior stakeholders with the intention of garnering support for the plan of reorganization.[22] By deploying part of their expected distributions, senior creditors "gift" these proceeds to a constituency who otherwise would not be entitled to a recovery by virtue of strict compliance with the APR.[23] Numerous courts (and the only circuit courts to address this issue) nix this gifting notion,[24] holding that under a plan of reorganization, a senior creditor cannot gift part of its distribution to a junior class and in turn bypass an intermediate class.[25] Such a gift, they reason, violates the APR by circumventing the rules for distributing property of the estate.[26] By denying these attempts at obtaining votes, the courts, at first glance, leave debtors who lack the necessary votes no path to restructure.

Hence, the conundrum faced by a debtor is how to restructure corporate assets when faced with the inability to propose a confirmable reorganization plan. Corporate debtors struggle with circumstances where (1) dissenting classes will reject the plan[27]; (2) the debtor cannot cram a plan over the objection of a secured creditor[28]; (3) the daunting

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19 *See generally* Kenneth N. Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 133 (1979).

20 Daniel R. Wong, Note and Comment, *Chapter 11 Bankruptcy and Cramdowns: Adopting a Contract Rate Approach*, 106 NW. L. REV. 1927, 1956–57 (2012).

21 Cram down allows a debtor to push a plan past a dissenting creditor only if the other statutory requirements are met. 11 U.S.C. § 1129(b)(1) (allowing cram down "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan").

22 *See In re* Armstrong World Indus., Inc., 432 F.3d 507 (3d Cir. 2005).

23 This constituency would also not be entitled to a recovery by virtue of the given insolvent debtor's financial situation, where more often than not, there are not enough assets to pay the claims of junior claimants. *See In re* Walter Energy, Inc., 542 B.R. 859 (N.D. Ala. 2015).

24 *See* DISH Network Corp. v. DBSD N. Am., Inc. (*In re* DBSD N. Am., Inc.), 634 F.3d 79 (2d Cir. 2011); *In re Armstrong*, 432 F.3d 507. *But see In re* SPM Mfg., Corp., 984 F.2d 1305 (1st Cir. 1993).

25 *See In re DBSD N. Am., Inc.*, 634 F.3d 79. The distinction between *DSBD* and *Armstrong*, which explains why *DBSD* is cited here, is that *DBSD* struck down a gift from a secured creditor, whereas the *Armstrong* gift came from one unsecured creditor to another unsecured creditor. *See id.*; *In re Armstrong*, 432 F.3d 507.

26 Section 541 defines what constitutes property of the estate. 11 U.S.C. § 541 (2012). Section 1129 provides how that property can be distributed under a reorganization plan. 11 U.S.C. § 1129.

27 *See* 11 U.S.C. §§ 1129(a)(8), 1129(a)(10).

28 To be confirmable, a plan of reorganization must provide secured creditors with the following, as outlined in 11 U.S.C. § 1129(b):

confirmation battle that will cost millions; and (4) the prolonged stay in Chapter 11 that will pose inherent risks to the enterprise. Against this backdrop, the Bankruptcy Code provides multiple restructuring alternatives, including § 363, which authorizes a debtor to sell its assets, outside of a plan of reorganization, free and clear of liens, claims, and encumbrances.[29] Section 363 sales allow the debtors and their purchasers flexibility to deal with a fully encumbered estate where value dictates that only the senior creditors will be paid.[30]

To demonstrate how § 363 provides a restructuring alternative,

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> (b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan. (2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements: (A) With respect to a class of secured claims, the plan provides—(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property; (ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or (iii) for the realization by such holders of the indubitable equivalent of such claims.

11 U.S.C. § 1129(b). Hence, in the absence of sufficient debt capacity that would allow a debtor to seek to provide a secured creditor with new secured debt in satisfaction of its claim, the secured creditors must be provided with the indubitable equivalence. *See* U.S. Bank Nat'l Ass'n v. Wilmington Sav. Fund Soc'y (*In re* MPM Silicones, L.L.C.), 531 B.R. 321 (S.D.N.Y 2015). Numerous courts agree that equity of the reorganized debtor cannot satisfy the indubitable equivalence requirement. This precludes the ability to cram down secured creditors with such equity. *Id.*

[29] 11 U.S.C. § 363; *In re* ICL Holding Co., Inc. (*LifeCare*), 802 F.3d 547, 549 (3d Cir. 2015) ("[Section] 363 allows a debtor to sell substantially all of its assets outside a plan of reorganization. In modern bankruptcy practice, it is the tool of choice to put a quick close to a bankruptcy case. It avoids time, expense, and, some would say, the Bankruptcy Code's unbending rules."); *see also* Robert C. Goodrich, Jr. & David W. Houston IV, In re *ICL Holding Co.: Roadmap for Avoiding the Absolute Priority Rule*, 2015 NORTON BANKR. L. ADVISER 1, 5 (2015) ("The primary alternative route is § 363, . . . without the procedural and substantive restrictions governing confirmation. There are certainly advantages to this route, *e.g.*, it is faster and cheaper . . . .").

[30] *See* RadLAX Gateway Hotel, L.L.C. v. Amalgamated Bank, 566 U.S. 639, 649 (2012) ("Because the RadLAX debtors may not obtain confirmation of a Chapter 11 cramdown plan that provides for the sale of collateral free and clear of the Bank's lien, but does not permit the Bank to credit-bid at the sale, we affirm the judgment of the Court of Appeals."); *see also* Goodrich, Jr. & Houston IV, *supra* note 29, at 1 ("The Committee pointed out that the sale would leave the estate administratively insolvent and provide nothing for the general unsecured creditors.").

envision a case[31] where the debtors pledged all of their assets to their secured creditors.[32] The secured creditors indicate to the debtor they will not support any plan of reorganization unless they are paid in full in cash.[33] The value of the assets does not exceed the secured debt. The secured creditors indicate, however, that they will support a quick sale to themselves.[34] Since the secured creditors have the right under § 363(k) to credit bid their debt at any auction,[35] and the asset value does not exceed the secured debt, it is highly likely that no other buyer will materialize.

The secured creditors form an acquisition vehicle[36] and use their debt holdings to "buy," pursuant to § 363, the assets already pledged as collateral.[37] Such a sale effectively yields no cash proceeds since the secured creditor bought all the company's assets including cash, accounts receivable, and intangibles.[38] Following the sale, the purchaser (former secured creditors) wishes to operate the business without the burdens of its prior liabilities.[39] The purchaser, however, does not need or want the services of certain vendors and employees and certainly does not want to pay the tax bill occasioned by the debtor's sale.[40] So, the purchaser decides to use its newly acquired assets and pay just some of the trade vendors and certain select employees and chooses to pay the

31 See Mooney, Jr., *supra* note 8, at 756 for a similar paradigmatic hypothetical.

32 *See* 11 U.S.C. § 101(10) (defining creditor); *Secured Creditor: What Is*, INVESTOPEDIA, http://www.investopedia.com/terms/s/secured-creditor.asp (last visited Feb. 13, 2017) ("Any creditor or lender that takes collateral for the extension of credit, loan or bond issuance.").

33 The debtor has no viable options vis-a-vis the secured creditor because the debtor cannot cram a secured creditor with equity and the debtor does not have sufficient debt capacity to propose a restructured loan to satisfy the secured claim.

34 *See* Steering Committee's Reply in Support of the Debtors' Motion for Entry of an Order Approving the Sale of Substantially All of the Debtors' Assets at 3, *In re* LCI Holding Co., Inc., No. 12-13319-(KG) (Bankr. D. Del. Mar. 28, 2013) [hereinafter Steering Committee's Reply], http://www.kccllc.net/document/1213319130328000000000023.

35 11 U.S.C. § 363(k). Because secured creditors have the ability to credit bid the full amount of their debt to in essence repurchase the assets pledged to them, such auctions rarely yield other potential purchasers. Said another way, if a truck was encumbered by secured debt of $100 and the truck had a market value of only $65, no rational buyer would pay more than $65, but the secured creditor can bid up to $100 as the purchase price. No other purchaser would pay as much and thus, the credit bid allows the creditor to recapture the asset. *See In re* Fisker Auto. Holdings, Inc., 510 B.R. 55 (Bankr. D. Del. 2014).

36 *In re* ICL Holding Co., Inc. (*LifeCare*), 802 F.3d 547, 549 (3d Cir. 2015) ("To memorialize the proposed sale, the secured lender group (through an acquisition vehicle called Hospital Acquisition, LLC) entered into an Asset Purchase Agreement with LifeCare . . . .").

37 *See id.* In simple terms, the secured creditors are buying the assets that are pledged to them to repay their original loan.

38 *See* U.C.C. §§ 9-101–9-809 (AM. LAW INST. & UNIF. LAW COMM'N 2000). Assets pledged by a debtor to a secured creditor are enumerated in pledge and security agreements, accompanying U.C.C.-1 and perfected under the applicable state Uniform Commercial Codes.

39 Section 363 expressly provides that assets may be sold free and clear of all liens, claims, and encumbrances. 11 U.S.C. § 363.

40 *See* Steering Committee's Reply, *supra* note 34, at 6–7 (highlighting some examples of the liabilities the purchaser has agreed to pay).

professionals for the debtor who helped effectuate the sale. Other creditors are left holding the unpaid bills since the residual estate, devoid of assets, has no cash or other assets to pay its bills. The tax bill goes unpaid; vendors who provided goods and services to the debtors are unpaid and have no prospects of being paid because there is no longer a business, just an empty shell corporation.[41] The purchaser continues the restructured business free and clear of these claims having only paid those needed for it to operate the business. This seems like a blatant end run around the APR. Or is it?

Does a § 363 sale allow a purchaser of the debtor's assets to redirect those assets to satisfy claims outside of the Bankruptcy Code's payment hierarchy?[42] The purchaser's directed payments outside of the strictures of the APR juxtapose competing interests in the restructuring arena, namely the Bankruptcy Code's hierarchical payment structure against the needs of a company aiming to stay intact as a going concern and preserve jobs.[43] Section 363 sales provide an effective vehicle to manufacture a result around the constraints imposed by the APR and the case law interpreting it. Absent an amendment to § 1129(b) (which is proposed in this Note and would remedy the temporal problems stemming from the case law that disapprove of gifts as violating the APR), § 363 sales—pursuant to which a purchaser redirects assets to satisfy certain creditors—best achieve the goals of Chapter 11 when a reorganization plan cannot be confirmed.

This Note analyzes the confluence of the APR and gifts, implicated in a § 363 context, as an alternative to Chapter 11 plans of reorganization, to explore whether gifts in § 363 sales,[44] are a circumvention of the Code's priority scheme contrary to the APR.[45]

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41 *See Shell Corporation*, INVESTOPEDIA, http://www.investopedia.com/terms/s/shellcorporation.asp (last visited Feb. 13, 2017).

42 *See In re LifeCare*, 802 F.3d 547; Ralph Brubaker, *Taking Chapter 11's Distribution Rules Seriously: "Inter-Class Gifting Is Dead! Long Live Inter-Class Gifting!"*, BANKR. L. LETTER, April 2011, at 1, 17 ("When the inter-class 'gift' is effectuated outside the context of a plan of reorganization, the extent to which the absolute priority rule and other plan distribution constraints are applicable, if at all, is highly uncertain.").

43 Douglas G. Baird & Thomas H. Jackson, *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 55 U. CHI. L. REV. 738, 740 (1988) (highlighting the concerns for different ownership layers, including but not limited to, old owners, suppliers, company managers, and shareholders).

44 *See In re LifeCare*, 802 F.3d 547. As discussed herein, redirecting assets bought by a creditor and which now belong to that creditor while technically not gifts of estate property bear all the hallmarks of gifts that have vexed courts when they occur under a reorganization plan. *See In re* DBSD N. Am., Inc., 634 F.3d 79 (2d Cir. 2011); *In re* Armstrong World Indus., Inc., 432 F.3d 507 (3d Cir. 2005). Throughout this Note, both plan redistributions and sale proceeds redeployment are referred to as gifts.

45 *See In re LifeCare*, 802 F.3d at 549 ("We conclude, as we explain more fully below, that neither of the two payments went into or came out of the bankruptcy estate. Thus the cash was not subject to the Code's distribution priority."); Goodrich, Jr. & Houston IV, *supra* note 29, at 5 ("If one is looking to *ICL* for further development of guidelines for the alternative route of

While courts clearly disapprove of plan gifts,[46] this Note will analyze whether the distinction between a plan gift of estate property and a gift from sales proceeds (which courts view as no longer estate property) is one without difference.[47] Further, this Note will examine whether there is a policy rationale between the different gifts and, in light of the costs and expense of Chapter 11s, whether § 363 gifts present a workable solution to allow distributions to junior stakeholders when senior creditors are not paid in full. Finally, this Note will explore alternatives available to a company faced with a fully encumbered estate and no assets to pay administrative or unsecured claimants.

This Note proceeds in five parts. Part I explores the foundation, nature, and debate surrounding the APR. Part II analyzes the evolution and devolution of the gifting doctrine, examining why gifts are not allowed in a plan of reorganization context. Part III considers gifting within § 363 sales amongst a discussion of reorganization alternatives. Part IV discusses *In re ICL Holding Co., Inc.* (*LifeCare*)[48] and its implications. Part V suggests an amendment to 11 U.S.C. § 1129(b)(2)(B)(ii) to better effectuate the intent of the Bankruptcy Code, demonstrates the amendment's application to relevant case law, and addresses counterarguments to the proposed amendment.

I. THE ABSOLUTE PRIORITY RULE

The APR traces its origins to early twentieth century restructurings plagued by collusion among old equity and secured creditors.[49] In the typical scenario, a company went into receivership and the receiver, with the consent of the secured creditors and the old equity, sold the assets of the company to a new entity formed by the shareholders of the failed enterprise at a price that satisfied just the secured debt thereby bypassing the unsecured claimants.[50] Such collusion typically resulted in

§ 363 sales, there is some disappointment but also a means of circumvention . . . . Parties in future cases, however, may have been given a roadmap to circumvent priority . . . issues."); Simon E. Fraser, *3d Circuit Bolsters "Gifting"*, 34 AM. BANKR. INST. J. 18, 105 (2015) ("[The decision] may also embolden parties to seek to use § 363 as an end run around the Bankruptcy Code's priority scheme and incentivize parties to . . . us[e] § 363 . . . as a distribution tool as well—one with far greater flexibility than § 1129.").

46 *See In re DBSD N. Am., Inc.*, 634 F.3d 79 (2d Cir. 2011); *In re Armstrong World Indus., Inc.*, 432 F.3d 507. Plan gifts are gifts that take place in the plan of reorganization context.

47 *See infra* Section IV.B

48 *In re LifeCare*, 802 F.3d at 549 n.1 ("LifeCare while in Chapter 11 was referred to as 'LCI.' Per its plan of reorganization it became 'ICL.' Hence we simply use the term 'LifeCare'.").

49 *See* N. Pac. Ry. Co. v. Boyd, 228 U.S. 482 (1913). *See generally* Douglas G. Baird, *The Hidden Virtues of Chapter 11: An Overview of the Law and Economics of Financially Distressed Firms* (Coase-Sandor Inst. for Law & Econ., Working Paper No. 43, 1997) (discussing generally the problems akin to railroad equity receiverships).

50 *See Boyd*, 228 U.S. at 488.

the squeeze-out of unsecured creditors from any distributions from the reorganized entity.[51] The Supreme Court in *Northern Pacific Railway Co. v. Boyd*,[52] recognized this problem and announced its "fixed principle": equity can never recover until secured and unsecured creditors recover in full or consent to an equity recovery.[53] The Supreme Court held that old equity and secured creditors cannot accomplish in court (with transfer of reorganized equity to old equity without paying unsecured claims) what could not be done in a private sale. The Court addressed the concerns that arise on a day of reckoning when ownership interests of those who have contributed capital to the enterprise are valued and assets of the enterprise are distributed according to said priorities.[54]

This fixed principle[55] was reinforced by the Supreme Court in *Case v. Los Angeles Lumber Products Co.*, which added a requirement that plans of reorganization be "fair and equitable."[56] In *L.A. Lumber*, the Court held that payment to creditors prior to recovery by old equity is a requirement "of full or absolute priority."[57] Although *L.A. Lumber* limited the application of this APR on a per creditor basis, the modern iteration of "fair and equitable" applied to classes of creditors, not individual creditors.[58] *L.A. Lumber* solidified common law notions of payment priority.[59]

Designed to ensure a debtor did not restructure for the benefit of old equity,[60] the Supreme Court required "creditors . . . be paid before the stockholders could retain [equity interests] for any purpose whatever."[61] As related to unsecured claims either: (1) the plan pays the

51 *See* Hollace T. Cohen, *The Absolute Priority Rule Revisited—How Absolute Is It?*, 18 J. BANKR. L. & PRAC. 279 (2009).

52 *Boyd*, 228 U.S. 482.

53 *Id.* at 507.

54 Baird & Jackson, *supra* note 43, at 740 ("Part of the initial bargain among those who contribute capital to a firm is an agreement about how assets of the firm will be divided if there is a day of reckoning on which everyone's ownership interest is valued.").

55 *See supra* text accompanying note 53.

56 Case v. L.A. Lumber Products Co. (*L.A. Lumber*), 308 U.S. 106 (1939).

57 *Id.*

58 *See* COLLIER ON BANKRUPTCY ¶ 1129.03(4)(a)(1) (Alan N. Resnick & Henry J. Sommer eds., 16th ed.) [hereinafter COLLIER ON BANKRUPTCY]; *see also* An Act to Establish a Uniform Law on the Subject of Bankruptcies, Pub. L. 95–598, 92 Stat 2549 (1978); Mooney, Jr., *supra* note 8, at 744 n.59. *L.A. Lumber* is also famous for suggesting in dictum the new value exception to the APR. When old equity provides new value necessary for the reorganization, then old equity may be permitted to retain its interests in the enterprise. *L.A. Lumber*, 308 U.S. 106. Perhaps the Supreme Court was suggesting that if, in *Boyd*, the new railroad acquiring entity paid full market value to the receiver, then the tort creditor, the unsecured creditor who was bypassed, never would have received the fraudulent conveyance remedy they claimed and won.

59 *See* COLLIER ON BANKRUPTCY, *supra* note 58, ¶ 1129.03(4)(a)(1).

60 *In re* Armstrong World Indus., Inc., 432 F.3d 507, 512 (3d Cir. 2005).

61 N. Pac. Ry. Co. v. Boyd, 228 U.S. 482, 508 (1913).

claims in full[62] or (2) the plan does not allow holders of junior claims to be paid anything prior to satisfaction of more senior claims.[63]

Therefore, a Chapter 11 plan aimed at reorganizing a business and supporting the positive income produced[64] shall be confirmed so long as the plan does not discriminate unfairly[65] and is fair and equitable.[66] That fair and equitable requirement is the codified APR.[67] Consequently, the plain textual scriptures of the Bankruptcy Code provided limited maneuverability on the part of debtors proposing a plan as the Code required distributions based on classification priority.[68]

But such strict adherence, some argue, is antithetical to reorganization's equitable principles.[69] Thus, just as practitioners sought to evade the common law notions of priority,[70] creative practitioners came up with a mechanism to side step the codified APR's perceived rigidity—the plan gift.

II. THE EVOLUTION OF GIFTING

The rationale behind the development of gifting is best exemplified

62 Section 1124 allows a debtor to unimpair or reinstate unsecured claims and hence their vote on a reorganization plan is not required, since that creditor is paid in full. 11 U.S.C. § 1124 (2012). But any alteration of the claims renders it impaired and § 1129(a) requires their affirmative vote or the vote of at least one impaired class of claims in order to proceed to cram down under § 1129(b). 11 U.S.C. § 1129. *See* COLLIER ON BANKRUPTCY, *supra* note 58, ¶ 1124.01 ("Determining whether a class is unimpaired under section 1124 becomes an important question in the plan confirmation process and for purposes of section 1129 of the Bankruptcy Code.").

63 11 U.S.C. § 1129(b)(2)(B).

64 Also called capturing the going-concern value. *See* Timm, *supra* note 2, at 1651 n.13.

65 Mooney, Jr., *supra* note 8, at 744 n.56 ("The statute does not define or explain the concept of unfair discrimination, although case law provides guidance." (citing Harvey R. Miller & Ronit J. Berkovich, *The Implications of the Third Circuit's* Armstrong *Decision on Creative Corporate Restructuring: Will Strict Construction of the Absolute Priority Rule Make Chapter 11 Consensus Less Likely?*, 55 AM. U. L. REV. 1345, 1387–1390 (2006))).

66 11 U.S.C. § 1129(b).

67 *See* COLLIER ON BANKRUPTCY, *supra* note 58, ¶¶ 1129.03–1129.04 (delineating various types of fair and equitable treatment under different sections of the Bankruptcy Code); *see also* 11 U.S.C. § 1129(b)(2)(B)(ii) ("the holder of any claim or interest that is junior to the claims of such [unsecured] class will not receive or retain under the plan on account of such junior claim or interest any property").

68 *See* 11 U.S.C. §§ 1122, 1123, 1124, 1129; *see also* COLLIER ON BANKRUPTCY, *supra* note 58, ¶¶ 1122.01, 1123.01, 1124.01, 1129.01–1129.04.

69 *See* Lubben, *supra* note 13, at 583–84 ("First, there is no absolute priority rule of the kind described in the literature under current law. It is not clear there ever has been such a rule. And even if there were, adopting such a rule would be inconsistent with Chapter 11, or any other sensible system of reorganization." (citations omitted)). Professor Lubben makes a cogent argument regarding the propriety of the APR. This Note, however, accepts that the Bankruptcy Code codified the APR as the payment waterfall.

70 *See* Brubaker, *supra* note 42, at 14 ("Indulging a 'gifting' exception to the absolute priority rule dramatically reworks the prevailing bargaining equilibrium and returns it to the pre-Code, pre-*Boyd* state of affairs.").

by an example.

A secured creditor[71] is owed $200, which is secured by all the assets of the debtor company. Unsecured funded debt creditors (i.e., bondholders) are owed $100. The trade creditors are owed $20. The shareholders, the company's equity interest holders, are entitled to the residual value of the company after the claims have been satisfied. The company itself is only valued at $150.

Secured Creditor	$200
Bondholders	$100
Trade	$20
Company Value	$150
Shareholder Deficiency	$(170)

In the above example, the secured creditor is entitled to the value of all the assets. Under the APR, the Chapter 11 plan would require the transfer of all the asset values to the secured creditor. Assuming the debtor has no capacity to incur and service debt, then the secured creditor will take 100% of the reorganized equity,[72] leaving nothing for bondholders, nothing for trade, and nothing for the shareholders.

This prospect logically dictates that the bondholders, trade creditors, and shareholders will vote against any such Chapter 11 plan because they are to receive no distribution.[73] Realizing this possibility, the secured creditor determines that redirecting part of its recovery (which is in the form of reorganized equity) to certain creditors will allow the secured creditor to gain support for the plan from other classes of creditors.[74]

The secured creditor proposes to give 10% of the reorganized equity (worth $15) split evenly between trade and shareholders. As a result, the secured creditor lowers his recovery from $150 to $135

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71 *See* sources cited *supra* note 32.

72 The secured creditor receives $150 in equity in satisfaction of its $200 claim, yielding seventy-five percent recovery.

73 11 U.S.C. § 1126(g) (a creditor or equity holder that receives no distribution under the plan of reorganization is deemed to automatically reject the plan).

74 Because 11 U.S.C. § 1122 allows for classification of claims. *See* U.S. Truck Co. v. U.S. Truck Co. (*In re* U.S. Truck), 800 F.2d 581, 584–86 (6th Cir. 1986) (discussing how Congress's codification of § 1122 left broad discretion for classification). Claims can only be in the same class if they are substantially similar to each other. While trade and unsecured bondholders are legally similar in priority, debtors often seek to manipulate classes by separately classifying trade and bondholders for the exact purpose of gerrymandering the vote of an impaired accepting class of creditors. Provided there is a business justification for the separate classification, courts permit such classification. *See id.* In this way a debtor can secure a positive vote. Gerrymandering votes and classification has spawned a lot of case analysis and divergent opinions. *See* Mark G. Douglas, *Insider's Acquisition of Claims to Create Accepting Impaired Class Constitutes Impermissible Gerrymandering*, JONES DAY (July/Aug. 2007), http://www.jonesday.com/files/Publication/ca67440f-4816-4e25-af35-2f2c5f590093/Presentation/PublicationAttachment/51340988-0fe2-4331-942b-31d59341ce19/Gerrymandering%20article%20for%20July_August%202007%20BRR.pdf.

(reducing his claim recovery from 75% to 67.5%). Trade creditors stand to yield $7.50 (for a 37.5%) recovery on their original $20 claim. And shareholders receive $7.50 when they were legally entitled to zero. In turn, both trade creditors and the shareholders happily vote yes and support the plan. The bondholders remain the lone dissenter to the proposed plan.

The motivations of the secured creditor are logical. Rather than risk a costly confirmation trial, and the disruption to the business (of which he is the primary beneficiary), the secured creditor determines that giving up $15 will yield a better dividend down the road.[75] The objection of the bondholders to such a scheme is similarly logical—strict application of the APR would yield zero for bondholders, but that also ensures the shareholder would receive zero.[76] Here, by virtue of the plan gift, the shareholder gets something, and the senior bondholder class gets nothing.

Is there something wrong with this? The gifting doctrine[77] exists within the codified priority framework.[78] Thus, the question presented by gifting plans is whether a senior creditor can gift part of the plan's distribution of the debtor's estate to a junior creditor (or shareholder) over the objection of a claim holder whose claim would be met—because of the application of the APR—before the junior stakeholder receives the gift.[79]

Gifting plans evolved from the desire to circumvent creditors who holdout or object to a plan.[80] While one of the laudable goals of Chapter

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[75] The secured creditor will yield a better dividend in terms of trade support of the ongoing business and the acumen of old equity, who principally ran the company.

[76] Bondholders may also assert an unfair discrimination objection to the plan of reorganization because trade creditors and bondholders who are both unsecured are receiving disparate treatment. 11 U.S.C. § 1129(b)(1). A discussion of unfair discrimination is beyond the scope of this Note.

[77] Term used synonymously with gifting or give-up. Although beyond the scope of this Note, another form of gift is a carve-out. Carve-outs are precisely what they purport to be. A secured creditor agrees to carve out collateral from its blanket lien to enable professionals to be paid from such collateral or its proceeds. However, such a carve-out can be viewed as a gift by the secured creditor (in the form of limiting its lien to certain collateral) to said professionals. As such, carve-outs may raise many of the same issues and concerns that courts struggle with as violating the APR. *See Professional Fee Carve-Out*, DAILY DEAL ACQUISITION CENT., https://www.dailydac.com/commercialbankruptcy/investors/glossary-terms/professional-fee-carve-out (last visited Feb. 13, 2017).

[78] *See* 11 U.S.C. § 1129(b).

[79] *See* Timm, *supra* note 2, at 1654 ("The practice of interclass gifting comes into conflict with the absolute priority rule in the situation in which a senior creditor gifts part of its expected distribution to a junior class, bypassing an intermediate class in the process." (citations omitted)).

[80] *See generally* Keven Yost, *The Choice Among Traditional Chapter 11, Prepackaged Bankruptcy and Out-of-Court Restructuring*, SEMANTIC SCHOLAR (Sept. 2002), https://pdfs.semanticscholar.org/aee1/826fa7dfbfe69cfd75b9b2028cc22aa6be9e.pdf (discussing, generally, holdout issues in both out-of-court and in-court contexts).

11 is consensus,[81] without the affirmative support of each impaired class,[82] recalcitrant creditors could simply derail Chapter 11 plans by launching costly and uncertain confirmation battles. Gifting served as one tool to counteract the threat of holdouts to plan confirmation.[83] Thus, gifting commandeers support for confirmation from either a junior class or from those tied to equity whose skills and knowledge would be helpful in maintaining future business prospects.

Proponents of gifts assert "[t]here is nothing in the Bankruptcy Code prohibiting creditors from agreeing to give up their [Chapter 11 plan] distributions and transferring that consideration to other classes of claims or interests."[84] Gifting is a method of trying to get a reorganization confirmed by giving away property expected in distribution to a junior claimant.[85] And, opponents say such gifts violate the APR by improperly diverting property of the estate outside of the strict requirement of the Bankruptcy Code's payment waterfall.[86]

As gifting practices began to take shape, courts confronted gifting in different restructuring contexts.

A. *Gifting in Chapter 7*

The First Circuit was the first appellate court to tackle the gifting doctrine, albeit in the Chapter 7 context.[87] In *SPM*, a manufacturer of photo albums and related products, had the following capital structure: (1) Citizens Savings Bank, the secured creditor, was owed $9 million, (2) unsecured trade creditors were owed $5.5 million, and (3) the Internal

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81 *See* An Act to Establish a Uniform Law on the Subject of Bankruptcies, Pub. L. 95–598, 92 Stat 2549 (1978).

82 *See* Baird, *supra* note 49, at 2 ("As long as creditors holding one class of impaired claims votes in favor of the plan, the rights of all the other creditors can be readjusted over their objection as long as various provisions of the Bankruptcy Code are satisfied").

83 *See* Brubaker, *supra* note 42, at 16.

84 Harvey R. Miller & Ronit J. Berkovich, *The Implications of the Third Circuit's* Armstrong *Decision on Creative Corporate Restructuring: Will Strict Construction of the Absolute Priority Rule Make Chapter 11 Consensus Less Likely?*, 55 AM. U. L. REV. 1345, 1391 (2006).

85 *See* Timm, *supra* note 2, at 1653 ("Interclass gifting is a practice . . . whereby one class 'gifts' or 'shares' part of the distribution it expects to receive under the Chapter 11 plan to another class.").

86 *See* Michael Carnevale, Comment, *Is Gifting Dead in Chapter 11 Reorganizations? Examining Absolute Priority in the Wake of the Second Circuit's No-Gift Rule in* In re DBSD, 15 U. PA. J. BUS. L. 225, 247 (2012). Carnevale argues for a rejection of gifting. *Id.* Carnevale points out that courts should be concerned with gifting being "used in nefarious manners." *Id.* Further, Carnevale articulates that if the Supreme Court takes a gifting case, and "if the holding restricts the practice of gifting," it should apply to both Chapter 7 and Chapter 11. *Id.* at 248.

87 *See In re* SPM Mfg., Corp., 984 F.2d 1305 (1st Cir. 1993); *see also In re* DBSD N. Am., Inc., 419 B.R. 210, 210–11 (Bankr. S.D.N.Y. 2009) ("Its rationale was explained in *SPM*, the case from which the doctrine first evolved."). Chapter 7 proceedings liquidate and sell a debtor's non-exempt assets.

Revenue Service (IRS), a priority creditor, was owed $ 0.75 million.[88] Attempts at a Chapter 11 plan of reorganization failed. Recognizing that liquidation would only yield recovery for Citizens, the trade committee entered into an agreement with Citizens which provided for a sharing of proceeds of the sale of the debtor's collateral, which had been pledged to Citizens.[89] The IRS was not party to this agreement.[90] The IRS objected to the propriety of this agreement. The IRS alleged that the property of the estate[91] (even though pledged to Citizens) should not have been distributed to unsecured creditors from Citizens.[92]

The First Circuit disagreed. In upholding this agreement, the court held "creditors are generally free to do whatever they wish with the bankruptcy dividends they receive, including to share them with other creditors."[93] The court reasoned further that temporally, once Citizens received its proceeds from the liquidation, the court can no longer touch money that belongs to Citizens.[94] In light of no statutory impediment to gifting in the Chapter 7 context,[95] the court held "[t]he Agreement did not affect estate property, i.e., the sale proceeds, but only concerned the contracting parties' *claims* against the estate, i.e., their rights to be paid by the estate."[96] The court was unconcerned with the redistribution of property that was no longer "property of the estate."[97]

Although effectuating a gift in the Chapter 7 context, where the APR does not apply, the rationale underlying *SPM* served as the building block for gifting Chapter 11 reorganization plans.[98] The logic being that reorganization plan proceeds were no longer the debtor's property but rather belonged to the creditor who could redirect those

88 *In re SPM*, 984 F.2d at 1307.

89 *Id.* at 1308.

90 *Id.*

91 *See* 11 U.S.C. § 541 (defining "property of the estate").

92 *In re SPM*, 984 F.2d at 1307–08 (the IRS objected to an agreement that "exclu[ded] the Internal Revenue Service and potential 'insider' creditors").

93 *Id.* at 1313.

94 *Id.* ("In this case, the proceeds of the sale of SPM's assets pursuant to 11 U.S.C. § 363 were property of the estate and thus the Code governed their use and distribution. However, once the court lifted the automatic stay and ordered those proceeds distributed to Citizens in proper satisfaction of its lien, that money became property of the Citizens, not of the estate . . . [T]he bankruptcy court has no authority to control how Citizens disposes of the proceeds once it receives them. There is nothing in the Code forbidding Citizens to have voluntarily paid part of these monies to some or all of the general, unsecured creditors after the bankruptcy proceedings finished.").

95 *Id.* at 1313–14 ("[A]ppellees' argument lacks statutory support . . . . We find no support in the Code for banning this type of contractual assignment in all cases.").

96 *Id.* at 1313.

97 *Id.* at 1314 ("[A]bsent some effect on the administration of the estate or diminution of estate property, neither the Code nor the Rules prohibit or discourage creditors from receiving cash from nondebtors [sic] in exchange for their claims.").

98 *See* Leah M. Eisenberg, *Gifting and Asset Reallocation in Chapter 11 Proceedings: A Synthesized Approach*, 29 AM. BANKR. INST. J. 50, 50 (2010) ("*SPM* formed the basis of law allowing 'gifting' to junior creditors out of the order of the Bankruptcy Code's priorities.").

proceeds as they saw fit.[99]

B. *Gifting in Chapter 11*

After the First Circuit's decision in *SPM*, gifting Chapter 11 plans enjoyed widespread acceptance.[100]

In *In re WorldCom Inc.*,[101] for example, there were two groups of trade creditors: (1) an ad hoc committee which consisted of hedge funds that had purchased trade claims from vendors at a discount and (2) general trade unsecured creditors. A separate unsecured bondholder class agreed to gift a portion of their recovery from the Chapter 11 plan to the ad hoc committee constituents but not to the other general trade unsecured creditors.[102] The proposed plan provided that acceptance by the bondholder class automatically conferred gifted recovery to the ad hoc committee.[103] Relying on the rationale of *SPM*, the *WorldCom* court approved of this gift.[104]

However, the Third Circuit, in 2005, reversed the gifting plan trend. In *In re Armstrong World Industries, Inc.*, the Third Circuit rejected the First Circuit's *SPM* rationale and the court held that a plan cannot give junior claimants plan distributions over the objection of a more senior class that is impaired.[105] Armstrong World Industries, which produced flooring products, filed for Chapter 11 to address asbestos liabilities.[106] The gift in *Armstrong*'s plan involved two unsecured classes of creditors: Class 6 consisting of general unsecured creditors; and Class 7 consisting of asbestos personal injury claimants.[107] The proposed plan was structured so that if Class 6 accepted the plan, the plan distribution of warrants[108] that was supposed to go to Class 6

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99 *See* Mooney, Jr., *supra* note 8, at 746 ("However, the distributional scheme under Chapter 7 is every bit as rigid as that under Chapter 11. The relevant inquiry, then, is whether gifting is a permissible means of allowing a junior creditor's recovery to the exclusion of a senior creditor, notwithstanding the otherwise applicable distributional regime (regardless of the applicable chapter).").

100 *See* Lauren E. McDivitt, Comment, *What Do You Mean There Won't Be Gifts This Year?: Why Practitioners Cannot Rely Upon Gifting Provisions in Chapter 11 Reorganization Plans in the Fifth* Circuit, 44 TEX. TECH. L. REV. 1019, 1030–32 (2012) (discussing *In re* MCorp Fin., 160 B.R. 941 (S.D. Tex. 1993) and *In re* Genesis Health Ventures, Inc., 266 B.R. 591 (Bankr. D. Del. 2001) as false glimmers of hope for gifting practices); *see also In re* Armstrong World Indus., Inc., 432 F.3d 507, 513–14 (3d Cir. 2005) (discussing the same line of cases).

101 *In re* WorldCom, Inc., No. 02-13533, 2003 WL 23861928 (Bankr. S.D.N.Y. Oct. 1, 2003).

102 *Id.*

103 *Id.* at *5

104 *Id.* at *61–62.

105 *In re Armstrong*, 432 F.3d 507.

106 *Id.* at 509.

107 *Id.*

108 *See Warrant*, INVESTOPEDIA, http://www.investopedia.com/terms/w/warrant.asp (last visited Jan. 8, 2017) ("A warrant is a derivative that confers the right, but not the obligation, to

instead automatically gifted said warrants to old equity. If not, those warrants went to Class 7, which then were in turn gifted to old equity.[109] Class 6 rejected the reorganization plan and was crammed down; Class 6 creditors objected to confirmation at the district court.[110]

The Third Circuit affirmed the district court holding that the reorganization plan violated the APR.[111] The Third Circuit embraced the district court reasoning that the *SPM* decision was inapposite because *SPM* concerned Chapter 7 where the APR did not apply.[112] Distinguishing *SPM*, the court reasoned that the secured creditor in *SPM* had substantive rights to assets by virtue of its lien and an ability to lift the automatic stay to realize the proceeds of that lien.[113] Hence, the secured creditor had a viable avenue to take possession of its collateral and do with it as it pleased.[114] The unsecured creditors in *Armstrong*, however, had no such rights to collateral. Thus, the unsecured creditors' rights to recovery was solely derivative of estate property (not like a secured creditor who has an interest in pledged collateral).[115] The Third Circuit, rejecting a flexible construction of § 1129(b)'s APR, held that such a gift would "encourage parties to impermissibly sidestep the carefully crafted strictures of the Bankruptcy Code."[116] While *Armstrong* chilled plan gifts, the Second Circuit's opinion in *In re DBSD North America, Inc.* effectively killed them.[117]

In *DBSD*,[118] a mobile satellite service operator, DBSD,[119] filed for

buy or sell security—normally an equity—at a certain price before expiration.").

109 *In re Armstrong*, 432 F.3d at 509 ("However, the Plan also provided that Class 7 would automatically waive receipt of the warrants, which would then be issued to AWWD or Holdings (Class 12).").

110 *Id.* at 510.

111 *Id.* at 518 ("We will accordingly affirm the District Court's decision to deny confirmation of AWI's Plan.").

112 Mooney, Jr., *supra* note 8, at 747 ("The court distinguished *SPM* because it was a Chapter 7 case that did not implicate the absolute priority rule." (citing *In re Armstrong*, 432 F.3d at 514)). But that distinction is largely without merit since 11 U.S.C. § 1129(a)(7), in part, incorporates the waterfall priorities of Chapter 11.

113 *In re Armstrong*, 432 F.3d at 514.

114 *Id.*

115 *Id. Armstrong* also distinguished *WorldCom* because *WorldCom* concerned distributions to classes of equal priority, and therefore, no absolute priority issues were implicated since all classes shared the same priority rights. *See In re* WorldCom, Inc., No. 02-13533, 2003 WL 23861928, at *61 (Bankr. S.D.N.Y. Oct. 1, 2003).

116 *In re Armstrong*, 432 F.3d at 514. The proposed plan restructuring in this case not only violates the APR but also, according to the court, undermines Congress's intention to give unsecured creditors bargaining power. *Id.* at 514–15 (citing H.R. REP. NO. 95-595, at 416 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6372, which reads, "[Section 1129(b)(2)(B)(ii)] gives intermediate creditors a great deal of leverage in negotiating with senior or secured creditors who wish to have a plan that gives value to equity.").

117 *See* Cohen, *supra* note 51. Cohen goes on to postulate that counsel's attempts to fashion plans that sidestep APR will run up against courts who must decide whether the sidestep is an effective and allowable creative solution or an impermissible attempt to circumvent APR. *Id.*

118 634 F.3d 79 (2d Cir. 2011).

119 *Id.* at 85.

Chapter 11 to avoid defaulting on its first and second lien debt.[120] The Debtors sought confirmation of a plan that satisfied the second lien claims by giving them ninety-five percent of the reorganized equity, paying unsecured creditors nothing and giving the remaining equity (five percent) to the old shareholders.[121] Sprint, which held a $2 million unsecured claim, asserted that the reorganization plan violated the APR because the old shareholders were receiving a recovery before the debtors' general unsecured creditors were fully satisfied.[122]

The Bankruptcy Court held that the APR applies only to distributions of "property of the estate" and thus did not prevent the second lien noteholders from redistributing property in which they had a perfected security interest.[123] The Bankruptcy Court was puzzled by Sprint's objection to the gift[124] because regardless of whether or not the gift occurred, no junior creditor would be injured. To the contrary, the court noted that the gifting only helps junior classes.[125]

The Second Circuit disagreed. The court found that the gift violated the statutory requirements, giving property to junior claimants both "under the plan" and "on account of" their interests.[126] The court found "[t]he existing shareholder received its property 'because of,' and thus 'on account of,' its prior interest . . . ."[127] In distinguishing the gift in *SPM*, the court stated "the property [in *SPM*] belonged to the secured creditor alone, and the secured creditor could do what it pleased with

120 *Id.* at 86. First lien debt has a contractual priority to the debtor's pledged collateral by virtue of an intercreditor agreement which dictates to the collateral trustee that the proceeds of the collateral must be paid over to first lien debt holders before second lien debt holders. *See Subordination Agreement*, INVESTOPEDIA, http://www.investopedia.com/terms/s/subordination-agreement.asp (last visited Feb. 13, 2017).

121 *In re* DBSD N. Am., Inc., 419 B.R. 179, 187–88 (Bankr. S.D.N.Y. 2009).

122 *In re DBSD N. Am., Inc.*, 634 F.3d at 88.

123 *In re DBSD*, 419 B.R. 179.

124 Am. Bar Ass'n Bus. Bankr. Comm. Webinar Panel on DBSD, DBSD*: Does it Portend the End of Gifting to Junior Classes and Claims Purchasing to Acquire Corporate Control?*, A.B.A. 7 (June 29, 2011), http://apps.americanbar.org/buslaw/meetings/audio/2011/CL160000/webinars/0611/20110629_businessbankruptcy_dbsd_webinar.pdf ("The [Second Lien] Noteholders had valid business reasons to share their own recovery with the Debtors' equity, and since unsecured creditors were not entitled to any recovery, Sprint had no reason to object to the gift.").

125 *In re DBSD*, 419 B.R. at 210–14 ("[W]hen the gift comes from a class with one or more duly perfected secured creditors . . . [a]nd if the secured creditor class is undersecured, that will mean, at least in most cases (as it does here), that any complaining creditor would get nothing anyway, whether or not the gift had been made—making it difficult, if not impossible, to see how the complaining creditor can be legitimately aggrieved by the gift . . . . [G]ifting here does not injure any junior creditor. In fact, the only class that receives less than its entitlement is the one agreeing to provide the gift. More junior creditors do better, not worse, by reason of the gift.").

126 11 U.S.C. § 1129(b) (2012); *see In re DBSD N. Am., Inc.*, 634 F.3d at 96–97. The court goes on the provide its understanding of the meaning of "under the plan" and "on account of." *Id.*

127 *In re DBSD N. Am., Inc.*, 634 F.3d at 96.

it . . . . [The property in *DBSD*] has never belonged to the secured creditors outright."[128] Although the Second Circuit acknowledged the policy arguments favoring gifting,[129] the court rejected these laudable goals instead favoring strict application of the APR because it was dealing with estate property, which does not belong to the creditor.[130] The Second Circuit did, however, allude to the limits of its holding by declining to rule on gifts "outside of a plan."[131]

Following *DBSD*, the courts have all but eliminated gifting in the Chapter 11 plan context as a means to give part of a creditor's distribution to a junior creditor while a higher priority creditor's claims continue to go unsatisfied because it offends the Code's priority scheme.[132]

C. *Gifts by Another Name*

1. Settlements Before a Plan of Reorganization

With gifting practices relegated out of Chapter 11 plan restructurings because of their violation of the Code's priority scheme, it follows that "there may be other ways to effectuate a 'gift' from a senior creditor to a junior creditor outside the confines of a strictly enforced [APR]."[133] Settlements serve as an alternative restructuring mechanism.[134] Creditors use settlements of legal disputes to justify the amount, priority, and distributions on account of claims. As such, settlements have become a potent vehicle in the attempt to get distributions into the hands of junior stakeholders without violating the

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128 *Id.* at 98. This is similar to the rationale used in *Armstrong*. Since an undersecured creditor has both a secured and unsecured claims, the undersecured creditor never really has possession of the collateral pledged to it. *See* 11 U.S.C. § 506(a). Hence the collateral is estate property. As such, the reorganization plan distributions are distributions of estate property and must adhere to the APR. *See In re DBSD N. Am., Inc.*, 634 F.3d at 100.

129 *Id.* ("Gifting [is] a powerful tool in accelerating an efficient and non-adversarial . . . chapter 11 proceeding." (quoting Leah M. Eisenberg, *Gifting and Asset Reallocation in Chapter 11 Proceedings: A Synthesized Approach*, 29 AM. BANKR. INST. J. 50, 50 (2010))).

130 *Id.* at 100–01.

131 *Id.* at 95 ("We need not decide whether the Code would allow the existing shareholder and Senior Noteholders to agree to transfer shares *outside* of the plan . . . ." (emphasis added)). The court seems to suggest that if you want to use a plan, then you must comply with § 1129. If you want to do something else, then the code is silent and you can skirt the APR. *See* Carnevale, *supra* note 86, at 243 ("The limits on acceptable parameters within a plan will result in practitioners working around these issues at an earlier stage in bankruptcy proceedings.").

132 Mooney, Jr., *supra* note 8, at 748 ("The court effectively eliminates gifting under a plan as a permissible means of providing value to a junior class when an intervening class of claims is not fully satisfied.").

133 Timm, *supra* note 2, at 1662.

134 *Id.* at 1665 ("[s]ettlements . . . resolve disputed claims to estate assets").

APR.

In *In re Iridium Operating L.L.C.*,[135] Iridium, a former Motorola, Inc. subsidiary which provided telecommunications services, filed for Chapter 11 after creditors filed involuntary petitions against certain affiliates.[136] Among its debt obligations, Iridium owed $800 million to a group of lenders (the Lenders).[137] According to the Lenders, the loans were secured by security interests in all of Iridium's assets, including roughly $156 million in cash deposits held in various bank accounts.[138]

The creditors' committee appointed in Iridium's Chapter 11 cases challenged the validity of the Lenders' security interest in Iridium's cash.[139] The committee argued the Lenders' interest in the cash, which transfer occurred within ninety days of the Chapter 11 filing, were avoidable as preferences.[140] The creditors' committee also asserted various claims against Motorola for breach of contract and fiduciary duty but lacked funds to pursue the litigation.[141]

The committee and the Lenders ultimately reached a settlement of their dispute and sought court approval.[142] The settlement provided for the distribution of the estate's cash to the Lenders and to a litigation trust, which was established to pursue the claims against Motorola.[143] Any recoveries from the litigation were to be divided among the Lenders, administrative creditors, and the estate (to be distributed under a future Chapter 11 plan).[144] Any cash remaining at the end of the litigation was to be paid directly to Iridium's unsecured creditors, whether or not the Lenders' claims or administrative claims were paid in full.[145] Motorola objected to the settlement, asserting that the settlement violated the APR by providing for the payment of estate assets to junior creditors (the litigation trust and the unsecured creditors) before any payments would be made to satisfy the administrative claims of Motorola.[146] The bankruptcy court and district court approved the

135 *In re* Iridium Operating L.L.C., 478 F.3d 452 (2d Cir. 2007).

136 *See id.* at 456–57. See 11 U.S.C. § 303 (2012) for an outline of how involuntary cases work.

137 *In re Iridium*, 478 F.3d at 457.

138 *Id.*

139 *Id.* at 458.

140 *Id.* 11 U.S.C. § 547 permits the debtor to claw back transfers made within ninety days of the Chapter 11 filing as preferential payments. The rationale behind preference causes of action is that creditors should not gain a preference over other similarly situated creditors because they were able to exert pressure on the debtor to pay them in that ninety-day window. 11 U.S.C. § 547.

141 *In re Iridium*, 478 F.3d at 458.

142 *Id.* at 458–59.

143 *Id.* at 459.

144 *Id.*

145 *Id.*

146 *Id.* at 462.

settlement over Motorola's objection.[147]

The Court of Appeals for the Second Circuit reversed.[148] At the outset, the Second Circuit distinguished the case from *SPM*, where there was no dispute that the lender had perfected liens on substantially all of the debtor's assets.[149] The Second Circuit then directed its attention to the standards applied to proposed settlements. Although the Bankruptcy Code expressly makes the "fair and equitable" requirement applicable only in cases of non-consensual confirmation of a plan, the Second Circuit explained that the Supreme Court has held "that a settlement presented for approval as part of a plan of reorganization, because it constitutes part of the plan, may only be approved if it, too, is 'fair and equitable' in the sense of conforming to the [APR]."[150] Thus, the *Iridium* holding, in part, mandates that settlements, which are part of a reorganization plan, that look like gifts must also not violate priority principles.[151] The court acknowledged, however, the lack of clarity surrounding the APR's application to pre-plan settlements, especially when the nature and extent of the bankruptcy estate are not fully resolved.[152]

The Second Circuit rejected application of the APR to all pre-plan settlements, observing that "a rigid *per se* rule cannot accommodate the dynamic status of some pre-plan bankruptcy settlements."[153] Mindful that rejecting strict application of the rule in all cases increases the risk that parties to a settlement may engage in improper collusion,[154] the Second Circuit opted instead for stricter scrutiny in the settlement approval process.[155] Under this standard, the Second Circuit explained, whether a settlement complies with the APR "will often be the dispositive factor."[156] Even so, the court observed, settlements that deviate in minor respects from that scheme may be approved, if the

147 Mark G. Douglas, *Application of the Absolute Priority Rule to Pre-Chapter 11 Plan Settlements: In Search of the Meaning of "Fair and Equitable"*, JONES DAY, http://www.jonesday.com/files/Publication/a6f5a354-29d7-46b9-8612-8b7a95de7b51/Presentation/PublicationAttachment/aa7510fd-15d3-4cde-aa9a-8dbebc0c25c2/JD_NYI_3996298_1_APR%20Appllication%20to%20Pre-Plan%20Settlements%20for%20May_June%202007%20BRR.pdf (last visited Jan. 7, 2016); *see also In re Iridium*, 478 F.3d at 460.

148 *In re Iridium*, 478 F.3d at 467.

149 *Id.* at 461 (The Court explained, "we need not decide if *SPM* could ever apply to Chapter 11 settlements, because it is clear that the Lenders [here] did not actually have a perfected interest in the cash on hand.").

150 *Id.* at 463.

151 *Id.*

152 *Id.* at 464.

153 *Id.*

154 See *supra* Part I discussing *Boyd* and *L.A. Lumber*.

155 *In re Iridium*, 478 F.3d at 464 (It concluded that "whether a particular settlement's distribution scheme complies with the Code's priority scheme must be the most important factor for the bankruptcy court to consider when determining whether a settlement is 'fair and equitable'. . . .").

156 *Id.*

"remaining factors weigh heavily in favor of approving a settlement" and the court clearly articulates the reasons for approving it.[157] In *Iridium*, however, because "no reason has been offered to explain why any balance left in the litigation trust could not or should not be distributed pursuant to the rule of priorities," the court reversed and remanded the case below for consideration of that issue.[158]

Read together, *Armstrong* and *Iridium* erect stringent standards governing settlement agreements, either as part of a Chapter 11 plan or a pre-plan settlement, that provide for distributions of assets in a way that deviates from the APR.[159] Both circuits require conformity with the strictures of the APR in evaluating settlements that appear to usurp the reorganization plan.[160] These rulings, however, stop short of a blanket prohibition of gifting through settlements.[161] First, the APR applies only in cases involving the nonconsensual confirmation of a Chapter 11 plan; if an intervening class of creditors does not object to a senior class give-up as a means of achieving consensual confirmation, the rule does not come into play. Second, cases involving redistribution from recoveries that would otherwise go exclusively to a senior class of secured creditors (as in *SPM*) are more likely to pass muster under the standards articulated in *Iridium* and *Armstrong*.[162]

2. Structured Dismissals

While the applicability of the APR in a Chapter 11 plan context seems unassailable, whether the APR permeates the entire Bankruptcy Code as an impediment to gifting is an open question.[163] The Supreme Court considered one such scenario in *Czyzewski v. Jevic Holding*

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157 *Id.*; *see also* Cohen, *supra* note 51.

158 *In re Iridium*, 478 F.3d at 466.

159 *See supra* Sections II.B, II.C.1.

160 *See supra* Sections II.B, II.C.1.

161 The Second Circuit did not break new ground in ruling that the terms of a pre-plan settlement should comply with the APR. In fact, the *Iridium* ruling is more flexible than at least one prior circuit court precedent. In *In re AWECO, Inc.*, the Fifth Circuit held that the APR must apply to pre-plan settlements, concluding that "a bankruptcy court abuses its discretion in approving a [pre-plan] settlement with a junior creditor unless the court concludes that priority of payment will be respected as to objecting senior creditors." *In re AWECO, Inc.*, 725 F.2d 293, 298 (5th Cir. 1984). In *In re Iridium Operating L.L.C.*, the Second Circuit declared that the rule stated in *AWECO* is "too rigid," emphasizing that "a rigid *per se* rule cannot accommodate the dynamic status of some pre-plan bankruptcy settlements." *In re Iridium*, 478 F.3d at 464. Instead, the Second Circuit determined that a pre-plan settlement may deviate from the Bankruptcy Code's priority rules if the "remaining factors weigh heavily in favor of approving a settlement" and the court clearly articulates the reasons for approving it. *Id.* at 464–65.

162 *See supra* Sections II.B, II.C.1.

163 Timm, *supra* note 2, at 1653 ("This requirement has plagued Chapter 11 reorganization efforts for years as practitioners persist in attempting to use methods that violate the absolute priority rule to gain support for a proposed plan." (citing Brubaker, *supra* note 42, at 1–2)).

Corp.[164] The Supreme Court granted certiorari in *Jevic* to decide whether bankruptcy courts are allowed to dismiss Chapter 11 cases when property is distributed in a settlement that violates the priorities contained in § 507.[165]

Structured dismissals, which remove the debtor from the auspices of the Bankruptcy Code, occur when the sale of a company's assets in Chapter 11 does not generate enough cash to pay priority claims in full thereby preventing confirmation of a plan.[166] In the unsuccessful reorganization of Jevic Holding Corporation, the official creditors' committee sued the secured lender and negotiated a settlement calling for the lender to set aside some money for distribution to unsecured creditors following dismissal.[167] The settlement's distribution scheme did not follow priorities in § 507 because wage priority claimants received nothing from the lender while lower-ranked unsecured claimants did.[168] Over the wage claimant's objection, the bankruptcy court's approval of the settlement was upheld in the district court and

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164 *See* Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973 (2017); Czyzewski v. Jevic Holding Corporation, SCOTUSBLOG, http://www.scotusblog.com/case-files/cases/czyzewski-v-jevic-holding-corporation (last visited Mar. 23, 2017).

165 *See Supreme Court Will Review Jevic to Rule on Structured Dismissals and Gift Plans*, AM. BANKR. INST., http://www.abi.org/newsroom/daily-wire/supreme-court-will-review-jevic-to-rule-on-structured-dismissals-and-gift-plans (last visited Dec. 31, 2016); Daniel Bussel, *Opinion Analysis: Bankruptcy Priority Rules May Not Be Evaded in Chapter 11 Structured Dismissals*, SCOTUSBLOG (Mar. 23, 2017, 6:38AM), http://www.scotusblog.com/2017/03/opinion-analysis-bankruptcy-priority-rules-may-not-evaded-chapter-11-structured-dismissals ("whether senior creditors whose liens exhaust a bankruptcy estate, and junior creditors or equity holders with control over the bankruptcy proceeding, can combine to use bankruptcy processes to implement a division of value that skips over otherwise out-of-the-money intervening creditors over their objection").

166 *See* 11 U.S.C. §§ 706(a), 1112(b) (2012).

167 Official Comm. of Unsecured Creditors v. CIT Grp./Bus. Credit Inc. (*In re* Jevic Holding Corp.), 787 F.3d 173, 177 (3d Cir. 2015).

168 *Id.* at 178 ("The Drivers and the United States Trustee objected to the proposed settlement and dismissal mainly because it distributed property of the estate to creditors of lower priority than the Drivers under § 507 of the Bankruptcy Code."). Section 507 lays out ten priority claims, a hierarchy. 11 U.S.C. § 507. Wage claimants are fourth priority and their priority is justified because

> by assuring employees of the debtor of a greater likelihood of payment for prepetition labor, it is believed that the employees are more likely to continue their employment, thus preventing dissipation of the debtor's business and preserving or increasing the proceeds that the case can generate for payment of creditors. There is, however, an added justification for the fourth and fifth priorities and that is for public policy reasons. Employees are viewed as having a special right to payment since their labor has helped to create the assets from which other creditors will be able to realize value and because their wages are often their only source of income. Creditors other than employees generally have not relied on the debtor as their sole source of income. In addition, other creditors typically have extended credit to the debtor on a voluntary basis, whereas employees in waiting for their paychecks do not consider themselves as extending credit to the debtor.

COLLIER ON BANKRUPTCY, *supra* note 58 ¶ 507.02(d).

the Third Circuit.[169]

The Third Circuit in *Jevic* recognized that certain facts constitute the "rare" circumstance that justifies dismissal and departure from rigid payment priorities.[170] The court expressed that the structured dismissal route is driven by the facts and here the wage priority claimants did not dispute the bankruptcy court's findings allowing a structured dismissal.[171]

Recommending that the Supreme Court review and reverse the Third Circuit, the Solicitor General said that "[b]ankruptcy is not a free-for-all in which parties or bankruptcy courts may dispose of claims and distribute assets as they see fit."[172] He argued that "[n]othing in the Code authorizes a court to approve a disposition that is essentially a substitute for a plan but does not comply with the priority scheme set forth in Section 507."[173] In granting review, the Supreme Court confronted,[174] in part, the sacrosanct nature of the APR and whether it

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169 *See In re Jevic Holding Corp.*, 787 F.3d at 180; Anthony W. Clark et. al., *Third Circuit Provides Road Map for Structured Dismissals*, SKADDEN (May 28, 2015), https://www.skadden.com/insights/third-circuit-provides-road-map-structured-dismissals ("[A] structured dismissal may be permissible under certain circumstances, even if distributions made in connection with such dismissal do not adhere to Bankruptcy Code Section 507's priority scheme.").

170 The court included a discussion of gifts in the form of settlements, discussing the difference between the Fifth Circuit's strict holding in *AWECO* and the Second Circuit's flexible holding in *Iridium*. *See In re Jevic Holding Corp.*, 787 F.3d at 183–84. The court noted that neither case addressed the question as to whether a court could approve a settlement that did not respect priority in the structured dismissal context, which is supposed to follow § 507 priorities. *Id.* at 185–86 ("Rather, we believe the Code permits a structured dismissal, even one that deviated from the § 507 priorities, when a bankruptcy judge makes sound findings of fact that the tradition routes out of Chapter 11 are unavailable and the settlement is the best feasible way of serving the interests of the estate and its creditors."). Nevertheless, the court appeared more influenced by the flexible standard outlined in *Iridium* and upheld the bankruptcy court's approval of the priority deviation. *Id.* at 184; *see* Marc Abrams, Paul V. Shalhoub, & Gabriel Brunswick, *Third Circuit Authorizes Structured Dismissal of Chapter 11 Case*, WILLKIE FARR & GALLAGHER (May 27, 2015), http://www.willkie.com/~/media/Files/Publications/2015/05/Third_Circuit_Authorizes_Structured_Dismissal_of_Chapter_11_Case.pdf; *see also* Lindsay M. Weber, *Third Circuit Find Escrow Funded by Secured Lenders Are Not Estate Property*, 2016 EMERGING ISSUES 7480 (Oct. 24, 2016) ("[T]he Third Circuit's *Jevic* decision provides additional authority for debtors to deviate from the Bankruptcy Code's priority rules through 'structured settlement' after a Section 363 sale.").

171 *See* Clark et. al., *supra* note 169. The court allowed the structured dismissal because it found no prospects for a confirmable plan and found that the success of a Chapter 7 conversion unlikely. *See In re Jevic Holding Corp.*, 787 F.3d at 185.

172 Brief for the United States as Amicus Curiae at 15, Czyzewski v. Jevic, 137 S. Ct. 973 (2017) (No. 15-649).

173 Brief for the United States as Amicus Curiae at 15, Czyzewski v. Jevic, 137 S. Ct. 973 (2017) (No. 15-649); *see supra* text accompanying note 165; *see also* COLLIER ON BANKRUPTCY, *supra* note 58 (discussing § 507 priorities).

174 An oral argument in front of the Supreme Court took place on December 7, 2016. The Supreme Court issued its opinion on March 22, 2017. *See* Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973 (2017).

permeates the entire Bankruptcy Code.[175]

The Supreme Court held that "a distribution scheme ordered in connection with the dismissal of a Chapter 11 case cannot, without the consent of the affected parties, deviate from the basic priority rules that apply under the primary mechanisms the Code establishes for final distributions of estate value in business bankruptcies."[176]

The Supreme Court, however, did not address the "in-between"[177] disposition of estate property that is caused by assets sales pre-confirmation but rather went to great lengths to focus on "final distributions," which occasion a case dismissal.[178] This is in stark contrast to § 363 sales which are understood to not be a final distribution,[179] as they "do not typically order final distributions. . . ."[180]

Although the Supreme Court overturned the Third Circuit, "the history of bankruptcy law suggests that the [Third] Circuit was not wrong in thinking that some degree of flexibility, ambiguity and uncertainty, rather than pristine enforcement of crisply defined legal priorities, is what best facilitates pragmatic resolution of complex Chapter 11 cases."[181] The Court's analysis also highlighted a nuanced approach to modern restructuring practices that, while technically violating the APR, furthered a reorganization objective and thus were justifiable.[182] The Court noted approvingly of first day wage orders and critical vendor orders that did not comply with the APR but furthered

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175 *Compare* Brief for Petitioner at 23, Czyzewski v. Jevic, 137 S. Ct. 973 (2017) (No. 15-649) ("Reading into the Code's provisions for dismissal or settlement a power to achieve what would be unlawful in a plan or liquidation fails to honor that basic precept."), *with* Brief for Amici Curiae Law Professors in Support of Respondents at 15, Czyzewski v. Jevic, 137 S. Ct. 973 (2017) (No. 15-649) ("Absolute priority was expressly limited to plan confirmation, and nothing else. The absolute priority rule should not be applied to this case, nor to any context outside of a plan of reorganization.").

176 *Czyzewski*, 137 S. Ct. at 978.

177 Bussel, *supra* note 165 ("The most interesting nuance in the court opinion is its brief discussion of Section 363 sales, which are a kind of in-between disposition. These sale orders . . . do not typically order final distributions except perhaps to secured parties, but they generally are case-dispositive and preordain the shape of the final distribution. The court cited with apparent approval the *Braniff* and *Lionel* cases, two 35-year old authorities that overturned Section 363 sale orders as evasions of Chapter 11's procedural requirements, and threw in a 'cf.' cite to the more recent *Chrysler* case, which controversially approved such a sale in an order that the Supreme Court subsequently vacated as moot.").

178 *Id.*

179 James H.M. Sprayregen, *Acquiring a Troubled Business in Bankruptcy or Outside of Bankruptcy*, KIRKLAND & ELLIS (1999), https://www.kirkland.com/siteFiles/kirkexp/publications/2554/Document1/Acquiring%20Troubled%20Business.pdf (noting that two standards considered in approving sales are how the sale affects future plans of reorganization).

180 Bussel, *supra* note 165.

181 *Id.*

182 *See* Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 985 (2017) ("We recognize that *Iridium* is not the only case in which a court has approved interim distributions that violate ordinary priority rules. But in such instances one can generally find significant Code-related objectives that the priority-violating distributions serve.").

the goal of achieving a subsequent confirmable Chapter 11 plan.[183]

The Supreme Court did not answer the lingering issue surrounding the disposition of estate property in a § 363 context and directing those proceeds to specific creditors.

The devolution of plan gifts demonstrates the lengths to which creative lawyers will go to salvage reorganizations. Because the courts effectively neutered plan gifts, and in light of the *Jevic* guidance, practitioners have employed and will continue to employ creative restructuring alternatives.

III. EXPLORING RESTRUCTURING ALTERNATIVES: 11 U.S.C. § 363

A. *The Problem of Administrative Insolvency*

Recall the earlier example of the fully encumbered estate[184] and assume now that the debtor has been operating under Chapter 11 protection for many months. Presumably, the debtor has incurred considerable professional fees, vendor claims, and employee obligations.[185] The debtor's business eroded during the Chapter 11 proceeding, decreased in value, and the debtor cannot pay its administrative creditors. Chapter 11 is not always the most successful route of business reorganization. Businesses can continue to lose money, and debtor estates can become encumbered, through the Chapter 11 process.[186] Once creditors come to the understanding they will not be fully rehabilitated, businesses take other efforts to salvage recovery.[187] However, the Code does not offer substantial guidance on the disposition of an administratively insolvent estate.[188] The problem of administrative insolvency is that administrative creditors (the very ones who have kept the company alive during Chapter 11) cannot recover because the debtor does not have asset value beyond its secured claims.[189] Thus, the debtor is faced with a Scylla and Charybdis

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183 *See* Stephen W. Sather, *Supreme Court Says Structured Dismissals Must Follow Priority Scheme*, A TEX. BANKR. LAW.'S BLOG (Mar. 22, 2017, 12:31 PM), http://stevesathersbankruptcynews.blogspot.com/2017/03/supreme-court-says-structured.html ("Thus, the court is not shutting the door on common practices in chapter 11 cases. Indeed, by referencing critical vendor orders, the Court may have implicitly expanded what is permissible.").

184 *See supra* Part II.

185 *See* 11 U.S.C. § 503 (2012) (allowing administrative expenses); 11 U.S.C. § 507(2) (delineating how those administrative expenses are paid).

186 *See* Alec P. Ostrow, *The Animal Farm of Administrative Insolvency*, 11 AM. BANKR. INST. L. REV. 339, 345 (2003).

187 *Id.* at 345.

188 *Id.*

189 *See* 11 U.S.C. § 101(32) (insolvent is the "financial condition such that the sum of such

dilemma[190]—it cannot propose a Chapter 11 plan, and it cannot satisfy its administrative creditors.

1. Conversion or Dismissal

In such circumstances, traditional Chapter 11 alternatives include conversion to Chapter 7 or case dismissal.[191] Upon conversion to Chapter 7, a trustee promptly liquidates assets and makes distributions as required by Chapter 7.[192] The drawbacks are that jobs are lost and the business functionally dies. The alternative option, dismissal of the Chapter 11 petition, provokes a race to the courthouse between the debtors' creditors to seize assets and results in the business's failure and unyielding chaos.[193] Conversion or dismissal most often result in value erosion. Hence, debtors seek alternative means to preserve their enterprise.

2. Alternative Methods

Administrative insolvency[194] creates a conundrum for debtors as they struggle with how to salvage jobs.[195] Traditional alternatives like conversion to Chapter 7 liquidation or dismissal of the Chapter 11 are undesirable.[196] As a result, some cases offer "creative" solutions that skirt the rigid payment waterfall of Chapter 11 in an effort to sustain the business and accompanying jobs.[197]

In *In re Caldor Inc.-NY*,[198] for example, the debtors failed in restructuring efforts for three years. The debtors desired to wind down[199] their businesses in a Chapter 11 believing that the forced

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entity's debts is greater than all of such entity's property").

190 HOMER, THE ODYSSEY 129–36 (E.V. Rieu trans., Penguin Books 2003) (1946) (a choice between two evils).

191 *See* 11 U.S.C. § 1112(b)(1).

192 Distribution of property of the estate in Chapter 7 is found in 11 U.S.C. § 726. *See* 11 U.S.C. §§ 701–727.

193 *See* 11 U.S.C. § 1112(b)(4).

194 *See* 11 U.S.C. § 101(32) (defining insolvency).

195 Forced liquidation of a company results in thousands of lost jobs. *In re* Walter Energy, Inc., 542 B.R. 859, 896 (N.D. Ala. 2015) ("The Debtors' dire circumstances require them to undertake the 363 Sale, or else they will cease operations and all employees' jobs will be lost.").

196 *See id.*; Ostrow, *supra* note 186, at 360; *see also supra* Section III.A.1.

197 Ostrow, *supra* note 186, at 359–64.

198 240 B.R. 180 (S.D.N.Y. 1999).

199 A wind down is simply slowing down all facets of a business until the business no longer operates. For example, reducing employees or having going-out-of-business sales or selling real estate. *See* Bob Eisenbach, *You Say You Want a Dissolution: An Overview of the Formal Corporate Wind Down*, COOLEY LLP (Feb. 24, 2015), http://bankruptcy.cooley.com/2015/02/articles/the-financially-troubled-company/you-say-you-want-a-dissolution-an-overview-of-a-

liquidation in Chapter 7 would yield lower proceeds.[200] Because the estate was administratively insolvent, the debtors obtained a wind down order from the bankruptcy court that established a payment hierarchy among the administrative creditors.[201] The order bifurcated administrative expenses into "Operating Period" and "Wind Down Period" claims.[202] "Wind Down Period" claimants were paid from liquidation proceeds first and then "Operating Period" claimants.[203]

The bankruptcy court approved this bifurcation of the administrative claims based on an analogy to § 364(c), which is used for debtors in possession financings.[204] The bankruptcy court held that Caldor was administratively insolvent and no third party would lend credit support or provide goods or services.[205] Hence, the alternative was conversion where all administrative creditors would be paid pro rata and after a Chapter 7 trustee's expenses.[206] Thus, this bifurcation was fundamentally a better outcome.[207] The district court agreed. The *Caldor* decision represents a successful liquidation of an administratively insolvent estate while skirting the APR.[208]

In re Teligent, Inc.[209] provides another example of creative approaches to dealing with administrative insolvency. In *Teligent*, after unsuccessfully operating in Chapter 11, the debtors, telecommunication services providers, decided to liquidate their assets by selling their core assets.[210] The debtors ultimately terminated their retail operations, sold certain assets, and used the proceeds from such sales to reduce their

formal-corporate-wind-down.

200 *In re Caldor Inc.-NY*, 240 B.R. at 183.

201 *See* Ostrow, *supra* note 186, at 361–62 n.126.

202 The Operating Period was the time period from the petition date to the order date. *See In re Caldor Inc.-NY*, 240 B.R. at 183. Wind Down Period claims were given super priority administrative expense status (senior to all other administrative claims). *See id.* at 184; *see also* 11 U.S.C. § 507(b) (detailing requirements for super priority).

203 *In re Caldor Inc.-NY*, 240 B.R. at 183.

204 11 U.S.C. § 364(c) ("If the trustee is unable to obtain unsecured credit allowable under section 503(b)(1) of this title . . . as an administrative expense, the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt—(1) with priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title . . . ; (2) secured by a lien on property of the estate that is not otherwise subject to a lien; or (3) secured by a junior lien on property of the estate that is subject to a lien."); *see* COLLIER ON BANKRUPTCY, *supra* note 58 ¶ 364.04 ("The power of the court to authorize the incurring of indebtedness with a priority over existing unsecured indebtedness, even indebtedness entitled to its own priority, is well recognized.").

205 *See In re Caldor Inc.-NY*, 240 B.R. at 189.

206 *See id.* at 188.

207 *See id.* at 190.

208 *See* Ostrow, *supra* note 186, at 362. ("The *Caldor* court thus creatively employed a superpriority [sic] provision, customarily used in debtor-in-possession financing, to facilitate the orderly liquidation of an administratively insolvent case.").

209 *In re* Teligent, Inc., 282 B.R. 765 (S.D.N.Y. 2002).

210 *See generally id.*

unsecured debt, with only their wholesale operations remaining.[211] The debtors were administratively insolvent owing over $100 million to administrative creditors, thereby precluding them from being able to confirm a reorganization plan.[212] Notwithstanding the debtors' obvious state of administrative insolvency, the debtors proposed a plan that provided for an administrative expense claim fund in the amount of $3.25 million, which was woefully inadequate to pay administrative creditors in full and would be shared pro rata.[213] If administrative creditors did not object they were deemed to consent to the pro rata treatment from the fund.[214]

The legal issue presented to the bankruptcy court was whether, under § 1129(a)(9), creditors' silence signaled consent to the debtors' proposed treatment of their claims.[215] The creditors did not return the consent forms to the debtors and did not object to the consent forms or object to the debtors' stated intention to ask the bankruptcy court to treat their silence as consent.[216] The bankruptcy court held, among other reasons,[217] in this instance, silence was tantamount[218] to a stated desire to advance "the other purpose of Chapter 11, namely [to] preserv[e] jobs . . . ."[219]

These creative solutions dealing with administratively insolvent estates allowed for distributions in violation of the APR. These examples demonstrate what debtors do when faced with untenable situations. While creative solutions might be desirable in rare situations, a panoply of cases that explore restructuring alternatives suggest that the APR may not be as foundationally important to the Bankruptcy Code as its drafters believed. So, is there an option?

Yes. Two, in fact. By amending § 1129(b), as discussed below,[220] courts can permit plan gifts. Alternatively, § 363 permits sales gifts.

211 *See id.* at 767.

212 *Id.* at 767–68; *see also* 11 U.S.C. § 1129(a)(9) (requiring a debtor to pay all administrative and priority creditors in full on the plan's effective date unless an administrative creditor agrees to different treatment).

213 *See In re Teligent*, 282 B.R. at 768.

214 *Id.* at 769.

215 *See* Ostrow, *supra* note 186, at 363–64*; see also* Andrew I. Silfen & Leah M. Eisenberg, *Creativity and Section 1129(a) Confirmation of Administratively Insolvent Debtor*, AM. BANKR. INST. J. (2003), https://www.abi.org/abi-journal/creativity-and-section-1129a-confirmation-of-administratively-insolvent-debtor.

216 *See* Silfen & Eisenberg, *supra* note 215.

217 *See id.*

218 *See* Ostrow, *supra* note 186, at 363 ("The court construed the silence as consent and confirmed the plan.").

219 Ostrow, *supra* note 186, at 365.

220 *See infra* Part V.

3. Section 363 Sales

As discussed above, courts have struggled with establishing a framework for allowing distributions to junior stakeholders via a path that does not do violence to the APR. Systematically, courts have neutered plan gifts,[221] challenged structured dismissals,[222] viewed settlement distributions skeptically,[223] and tried to avoid the undesirable outcomes occasioned by conversion or dismissal.[224] The unifying theme in these cases is the undertone of wanting to respect the APR but avoid its harsh consequences. But, there is a way.

Section 363, which governs sales of assets outside of the ordinary course of business,[225] provides an alternative to Chapter 11 reorganization plans.[226] Initially, courts, skeptical of the quick disposition of a debtor's core assets, viewed § 363 sales negatively. The criticisms leveled at such sales included: (1) a prompt sale of assets is often unlikely to yield the best price because the assets have not been marketed sufficiently[227]; (2) blind adherence to prompt sales can result in priority tax liabilities pursuant to § 503(b)(1)(B)[228]; (3) § 363 sales do not afford creditors "the procedural protections of Chapter 11"[229]; and (4) § 363 sales are fertile ground for bastardizing the Bankruptcy Code's

221 *See supra* Section II.B.

222 *See supra* Section II.C.2.

223 *See supra* Section II.C.1.

224 *See supra* Section III.A.1.

225 11 U.S.C. § 363(b)(1) (2012) ("The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate . . . .").

226 *See* Jacob A. Kling, *Rethinking 363 Sales*, 17 STAN. J.L. BUS. & FIN. 258, 260–64 (2012).

227 *Id.* at 265–66 ("The failure of a 363 sale to yield the best available price for the assets is problematic both because it reduces recovery for creditors and because the assets might not go to the purchaser that can put them to their most productive use.").

228 *See* United States' Objection to the Sale of Substantially All of the Debtors' Assets at 1, *In re* LCI Holding Co., Inc., No. 12-13319-KG (Bankr. D. Del. Mar. 8, 2013), http://www.kccllc.net/document/1213319130308000000000006 ("Because the stalking horse bid is substantially higher than the tax basis of the assets, the proposed sale will result in a significant amount of tax liability."). 11 U.S.C. § 503(b)(1)(B) outlines that taxes incurred by the estate become an administrative expense entitled to second priority under § 507(a)(2). *See* 11 U.S.C. § 503(b)(1)(B). Logically, taxes can only be incurred post-petition, because pre-petition there is no estate. *See* COLLIER ON BANKRUPTCY, *supra* note 58, ¶ 503.07. In addition, taxes incur when they accrue and become a fixed liability. *See In re* Federated Dep't. Stores, Inc., 270 F.3d 994, 1001 (6th Cir. 2001). It is fair to conclude from this that a § 363 sale will create taxes incurred by the estate, thus creating the discussed tax liabilities.

229 Kling, *supra* note 226, at 267; *see also* Elizabeth B. Rose, Comment, *Chocolate, Flowers, and § 363(B): The Opportunity for Sweetheart Deals Without Chapter 11 Protections*, 23 EMORY BANKR. DEV. J. 249, 263 (2006) ("General unsecured creditors lose more than negotiating leverage in a preplan sale; they lose § 1129 protections of the 'absolute priority rule' . . . ."); George W. Kuney, *Misinterpreting Bankruptcy Code Section 363(f) and Undermining the Chapter 11 Process*, 76 AM. BANKR. L.J. 235, 278 (2002) (balancing the positive and negative effects of an increase in the number of preplan sales on "less-than-administrative priority creditors").

foundational principle—the equal treatment of similarly situated creditors.[230] These shortcomings result because the Bankruptcy Code and its associated rules were not drafted to accommodate the procedure and substance of § 363 sales.[231]

Despite these shortcomings, § 363 sales became known for the speed and cost efficiency of effectuating asset transfers,[232] advancing several of the fundamental goals of reorganization, including continuing business, keeping employees in jobs,[233] and reducing administrative costs.[234] Provided there is a sound business justification for such a sale,[235] § 363 sales serve as a restructuring alternative for practitioners to effectuate what could not be achieved in the plan context, namely getting a distribution to junior stakeholders when a senior one is not paid in full.[236]

Balancing these concerns,[237] courts paved a middle ground by articulating a rule "requir[ing] that a judge determining a § 363(b) application expressly find from the evidence presented before him at the hearing a good business reason to grant such an application."[238]

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230 *See* Kling, *supra* note 226 (citing 11 U.S.C § 1129(b)).

231 George W. Kuney, *Let's Make It Official: Adding an Explicit Preplan Sale Process as an Alternative Exit from Bankruptcy*, 40 HOUS. L. REV. 1265, 1290–91 (2004) ("Because the Code and the Rules were not drafted with a nonplan sale of substantially all the assets of a business in mind as a Chapter 11 reorganization strategy, no cohesive regimen or bright-line rules regarding the substance or procedure of such a sale have emerged . . . . Formalizing nonplan sale practice and importing the concept of 'adequate information' from § 1125 should increase uniformity and the understanding of the standards to be applied to address procedural and substantive concerns.").

232 *See* Kling, *supra* note 226, at 262 ("Asset sales under section 363 have become an increasingly popular alternative to traditional Chapter 11 reorganizations . . . . [A] 363 sale can be accomplished more quickly and at less cost than a full blown reorganization.").

233 Kling, *supra* note 226, at 263; Debtors' Omnibus Reply to Objections to Debtors' Motion for Order (I) Approving the Sale of Substantially All of the Debtors' Assets; (II) Authorizing the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases; and (III) Granting Certain Related Relief at 3, *In re* LCI Holding Co., Inc., No. 12-13319-KG (Bankr. D. Del. Mar. 28, 2013), http://www.kccllc.net/document/1213319130328000000000019.

234 *See* Kling, *supra* note 226, at 262 n.20 ("But the reduction in administrative costs is independent of the timing of the distribution"); *see also In re* ICL Holding Co., Inc. (*LifeCare*), 802 F.3d 547, 550 (3d Cir. 2015) (Section 363 sale generated $24 million plus dollar tax claim IRS was pursuing as administrative creditor.). See COLLIER ON BANKRUPTCY, *supra* note 58, at ¶ 363.02 for an overview of the § 363 sale doctrine. *See also* Sprayregen, *supra* note 179 (outlining the stages of § 363 sales).

235 The *Lionel* Court laid the foundational interpretation of § 363 sales. *See* Lionel Corp., Comm. of Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063 (2d. Cir. 1983) (discussing sound business justification); *see also* Kling, *supra* note 226, at 261–64 (discussing the benefits of § 363 sales); Rachael M. Jackson, Survey, *Responding to Threats of Bankruptcy Abuse in a Post-Enron World: Trusting the Bankruptcy Judge as the Guardian of Debtor Estates*, 2005 COLUM. BUS. L. REV. 451 (providing an overview of asset sales).

236 *See supra* notes 30–41 and accompanying text.

237 And responding to quick asset dispositions that are aimed "to pacify large creditors with whom the debtor would expect to do business, at the expense of small and scattered public investors." *In re Lionel Corp.*, 722 F.2d at 1070.

238 *Id.* at 1071. While the Code does not formally offer a standard for approving these sales,

Nonetheless, § 363 sales are not a panacea to the rigidity of the APR.[239]

IV. *LIFECARE*

A. *Discussion*

The Third Circuit's *LifeCare* decision is the culmination of prior attempts to respect the APR but avoid its harsh consequences. The *LifeCare* disposition attempted to resolve the perceived rigidity of the APR and sanction a way around.

LifeCare Holdings, Inc. struggled to operate twenty-seven long-term acute care hospitals following Hurricane Katrina in 2005.[240] After exploring its options for restructuring, LifeCare ultimately decided to sell its assets to its secured lenders by accepting a credit bid.[241] In addition to the Asset Purchase Agreement, the acquisition group as "purchaser agreed to pay the legal and accounting fees of LifeCare and the committee of unsecured creditors and to pick up the tab for the company's wind-down costs" by placing the funds into escrow.[242]

Two creditors objected to the sale, the creditors' committee and the IRS.[243] The basis of each objection was rooted in having claims that would go unpaid if the sale went through.[244] The committee ultimately withdrew its objection and received as consideration a trust in the

courts have approved sales if the sale is based on the sound business judgment of the debtor. To determine if there is a sound business purpose, courts look to the non-exhaustive list of factors: (i) the proportionate value of the asset to the estate as a whole; (ii) the amount of elapsed time since the filing; (iii) the likelihood that a plan of reorganization will be proposed and confirmed in the near future; (iv) the effect of the proposed disposition on the future plan of reorganization; (v) the proceeds to be obtained from the sale versus appraised values of the assets; and (vi) whether the asset is decreasing or increasing in value. *Id.*

239 *See* Brubaker, *supra* note 42, at 17 ("When the . . . 'gift' is effectuated outside the context of a plan of reorganization, the extent to which the absolute priority rule and other plan distribution constraints are applicable, if at all, is highly uncertain . . . . given the realities of modern-day Chapter 11 practice, resolving that very issue is the central challenge confronting reorganization courts today, and at stake is nothing less than preserving (or abandoning) the very core and essence of bankruptcy reorganization law.").

240 *In re* ICL Holding Co., Inc. (*LifeCare*), 802 F.3d 547, 550 (3d Cir. 2015).

241 *Id.* at 549; *see* Vincent S. J. Buccola & Ashley C. Keller, Essay, *Credit Bidding and the Design of Bankruptcy Auctions*, 18 GEO. MASON L. REV. 99 (2010) (explaining credit bidding).

242 *In re LifeCare*, 802 F.3d at 550. Post hoc reports of the case point out that the agreement to cover costs through escrow was put into the purchase agreement. *See* Fraser, *supra* note 45, at 105 ("[T]he purchase agreement explicitly listed these funds as part of the sale consideration.").

243 *In re LifeCare*, 802 F.3d at 550–51.

244 The creditors' committee argued the estate would be administratively insolvent. *Id.* at 551. The IRS argued that the sale, based on the asset structure of LifeCare Holdings, would generate an estimated $24 million tax liability that should be paid to the government as an administrative claim of equal priority to the administrative legal fees claim being paid. *Id.*

amount of $3.5 million to benefit the unsecured creditors.[245] The IRS objected to the committee settlement and the sale arguing that the establishment of a trust for unsecured creditors violated the APR because the IRS's priority claim should have been satisfied before the unsecured creditors' claims.[246] The IRS asserted that both the settlement and the escrow consideration were part of the overall consideration for the larger sale, and thus proceeds of estate property, and subject to priority distribution rules.[247]

The bankruptcy court approved the sale and the settlement over the government's objection, which was affirmed by the district court.[248]

The Third Circuit, in upholding the sale and distributions under the settlement, analyzed whether the property of the estate was utilized via (1) the funds paid to the unsecured creditors in the settlement and (2) the funds paid in escrow to the administrative creditors.[249] Property of the estate, as defined in § 541(a)(6), includes "proceeds, product, offspring, rents, or profits of or from property of the estate"[250] and is subject to the priority scheme of the Bankruptcy Code.[251]

The Third Circuit held that once the secured creditors bought the assets of the debtor, those assets were properly categorized as the creditors'—and not the estate's—property.[252] Thus, because the assets were no longer the estate's property, the distribution of those assets did not have to comply with the APR.[253] The Third Circuit also "suggested, without deciding, that those [APR] rules may be properly limited to plan confirmation."[254] In sum, in *LifeCare*, the Third Circuit (1) reaffirmed its disapproval of gifting Chapter 11 plans; (2) reaffirmed that property of the estate is the lynchpin to any analysis of the APR;

245 *Id.* ("[T]he Committee struck a deal with the secured lender group. In exchange for the Committee's promise to drop its objections and support the sale, the secured lenders agreed to deposit $3.5 million in trust for the benefit of the general unsecured creditors.").

246 *See* Weber, *supra* note 170.

247 *See* Goodrich, Jr. & Houston IV, *supra* note 29, at 4; Weber, *supra* note 170.

248 *See In re* LCI Holding Company, Inc., 519 B.R. 461 (D. Del. 2014).

249 *See In re LifeCare*, 802 F.3d at 555.

250 11 U.S.C. § 541(a)(6) (2012).

251 *See* Goodrich, Jr. & Houston IV, *supra* note 29, at 3; Weber, *supra* note 170.

252 *In re LifeCare*, 802 F.3d at 555.

253 *Id.* at 558. The court framed the questions presented in terms of the two arguments that the government made on appeal.

> The Government's argument relies on two key premises. The first is that the escrowed funds for professional and settlement proceeds for unsecured creditors were property of the estate. (The Code's distribution rules don't apply to nonestate [sic] property.) The second is that the priority-enforcing Code rules apply here even if textually most (save for § 507) are limited to the plan context. We begin (and end) with the first issue.

Id. at 555; *see also* Goodrich, Jr. & Houston IV, *supra* note 29, at 4–5 ("Having held that neither the escrowed funds nor the settlement funds were property of the estate, the absolute priority rule . . . [was] not implicated and the Third Circuit made no ruling on [that] issue[].").

254 Goodrich, Jr. & Houston IV, *supra* note 29, at 4.

and (3) reaffirmed that the textual requirements of § 1129 do not necessarily apply in § 363 sales.[255] Thus, the Third Circuit implicitly endorsed that the APR does not apply to § 363 sales and hence, purchasers were free to redirect their acquired assets to pay certain claims and not others. In other words, the purchaser could gift.

B. *Practical Implications*

LifeCare "has provided a road map for addressing demanding creditors and a practical way around the [B]ankruptcy [C]ode's distribution scheme."[256] But that might not be a good thing as forcing § 363 sales are not necessarily the optimal vehicle to rehabilitate a business.

As a consequence of *LifeCare* allowing purchasers to gift their own assets, plan gifts and sales proceeds gifts are functionally no longer the same. Both emanate from the proceeds of property of the estate. However, the law has made a temporal distinction between when the proceeds funnel through a plan, where gifts are not permitted, and when the proceeds emanate from sales, where gifts are permitted. The key is "property of the estate"[257] and the dictates of § 1129.[258] While a distribution that results from a reorganization plan is the payment of claims from estate property and thus must comply with the APR, sales proceeds distributed under a § 363 sale lose their definitional cloak as estate property once the court enters a § 363 "free and clear" order. After that order the proceeds belong to the creditor who is free to do with them as he deems appropriate.[259] The temporal distinction seems misplaced since § 1141(c)[260] re-vests in the debtor property free and

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255 *See In re LifeCare*, 802 F.3d 547.

256 Jennifer B. Lyday & Jason H. Watson, *Recent Developments in Chapter 11*, 2016 ANN. SURV. BANKR. L. 30.

257 *See supra* note 250 and accompanying text.

258 11 U.S.C. § 1129 (2012).

259 *See In re LifeCare*, 802 F.3d at 556 (citing *In re* TSIC, Inc., 393 B.R. 71, 77 (Bankr. D. Del. 2006)). In other words, what the debtor comes to possess after a § 363 free and clear order can no longer be categorized as property of the estate pursuant to § 541. What results, as noted by Judge Gerber sitting in the Bankruptcy Court, is the distribution belongs to the creditor. Judge Gerber seems to suggest that he, as the judge, cannot impose limits on what the creditors can do with their own money. *In re* DBSD N. Am., Inc., 419 B.R. 179, 211–12 (Bankr. S.D.N.Y. 2009) ("Conversely, when the gift comes from a class with one or more duly perfected secured creditors, the rationale for the doctrine is particularly strong, as *the secured creditor class has a property interest in the property it has elected to gift, and if it were to enforce its security interest, the property would never become part of the estate to be subject to distribution to unsecured creditors under a plan* . . . I conclude that I too should follow the Gifting Doctrine—at least where, as here, the gift comes from the secured creditors." (emphasis added)).

260 11 U.S.C. § 1141(c) ("Except as provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and

clear of claims (except as otherwise provided for in the reorganization plan) in precisely the same way as a § 363 sale order vests such assets in the hands of a purchaser free from claims against the debtors' assets.[261] As such, but for the timing, a gift of sales proceeds and plan distributions are legally the same.

V. Proposal and Application

A. *Proposal*

To resolve the uncertainty[262] and tenuous nature of the temporal distinctions between sale and plan gifts, a proposed amendment to § 1129 that permits a creditor to redirect its plan distributions to another class of creditors would obviate the temporal distinction and better effectuate the intent of the Bankruptcy Code. Upon a reorganization plan's effective date, property of the estate re-vests in the debtor (who is now rehabilitated).[263] The estate has been fully administered. Allowing a creditor on the effective day plus one to direct its distribution to whomever it pleases not only comports with the textual confirmation requirements but also provides a workable solution to address the holdout issue.[264] Nothing in the Code prevents this and the property is no longer of the estate once the plan is effective. This highlights the unworkable nature of rigid application of the textual approach to plan gifts. A secured creditor cannot redirect a distribution under a plan at the effective date, but a day later the senior creditor has the liberty to distribute however it pleases. This difference is because the courts give great weight to the definition of property of the estate.[265] In other words, a creditor's ability to distribute hinges on whether or not it is temporally holding property of the estate. This rigid adherence to textualism defeats an otherwise workable plan.

Hence, in order to effectuate the goal of Chapter 11 to restructure the business for the benefit of all its stakeholders, including employees, vendors, customers, and the like, § 1129 should be amended.

New § 1129(b)(2)(B)(ii) would insert at the outset: "Except for any distribution from a holder that is senior to the claims of such class hereunder . . . ."[266]

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interest of creditors, equity security holders, and of general partners in the debtor.").

261 11 U.S.C. § 363.

262 *See* Brubaker, *supra* note 42.

263 *See supra* note 260.

264 *See* Yost, *supra* note 80.

265 *See supra* note 250 and accompanying text.

266 An amendment of this nature would require a corresponding amendment to 11 U.S.C. § 1129(b)(2)(C) that would address gifts to equity.

Such an amendment will disincentivize holdout classes[267] and facilitate speedier and more efficient Chapter 11 reorganization plans. Absent such an amendment, § 363 sales will continue to provide the mechanism to effectuate distributions to junior stakeholders from senior creditors while also, theoretically, respecting the APR.[268]

B. *Application*

1. In Favor of Proposal

Applying this proposed amendment to the cornerstone cases addressing gifts yields positive results that further Chapter 11's goals. The *Armstrong* plan would have been confirmed as the amendment would have permitted the gift. Instead, *Armstrong* languished in Chapter 11 longer and cost the estate millions of dollars in professional fees.[269] Similarly, in *DBSD* the plan would have been confirmed and the junior stakeholders would have received a recovery. Instead, DBSD was mired in litigation for years precluding the debtors' assets from re-entering the marketplace appropriately capitalized.[270] The amendment would have expedited plan confirmation in both instances and would have saved appellate litigation and reorganization expenses because these permissible gifts would not be the subject of litigation, creditor objection, and judicial scrutiny; the gifts would not violate the proposed new § 1129(b).

Further, as applied to *LifeCare*, the amendment would have permitted expeditious confirmation of a reorganization plan, rather than a sale. The proposed amendment would streamline plan confirmation and negate a textual creditor objection. The amendment has the consequence of neutering holdouts,[271] redeploying debtor's assets into the marketplace quicker, and enticing creditors toward consensus and swift resolution.

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267 *See* Kling, *supra* note 226, at 271 ("In the bankruptcy context, by contrast, the above discussion [about § 363 sales] suggests that unsecured creditors may have an incentive to hold up an efficient sale.").

268 By following the path trail-blazed by *LifeCare*. *See supra* Section IV.A.

269 The fees spawned further litigation. *In re* Armstrong World Indus., Inc., 366 B.R. 278, 278 (D. Del. 2007) ("Presently at issue are the fee petitions.").

270 *See* Eric Hornbeck, *DBSD Noteholders Try to Salvage Ch. 11 Plan*, LAW360 (Feb. 28, 2011), https://www.law360.com/newyork/articles/228627/dbsd-noteholders-try-to-salvage-ch-11-plan (discussing ten-month delay and inability to redeploy the debtors' assets into the marketplace).

271 *See supra* notes 80–83 and accompanying text; *see also supra* note 259.

2. Counterarguments

One of the founding principles of the Bankruptcy Code is the APR,[272] and the proposed amendment creates an exception to the rigidity of the APR.[273] The specificity of the APR allows for uniformity of application by the courts. Concerns will abound in circumstances where the exception swallows the rule. For example, assume junior creditors challenge the lien of a secured creditor, but the debtor and the secured creditor agree to settle that dispute provided the secured creditor gives up value to management, old equity, and trade creditors.[274] Because the standard for approval of a settlement is not taxing,[275] this example settlement will be approved and issues regarding end-runs around the APR will persist. At some point, the goals of Chapter 11 must yield to the rule of law and not permit such mischief. Sanctioning of gifts, however, as the proposed amendment envisions will necessarily dampen the enthusiasm to skirt the APR.

Conclusion

The laudable goals of the Bankruptcy Code operate within a statutory framework that created efforts to skirt the perceived rigidity of the APR. The practice of gifting evolved precisely because debtor's sought to effectuate a reorganization within the Bankruptcy Code's boundaries utilizing the available tools. As a result, courts restricted the ability to step out of the bounds of the Bankruptcy Code (by precluding the redirection of plan distributions since the distributions were still property of the estate) even though these efforts aimed to save jobs and enhance recoveries. Consequently, practitioners sought new ways to achieve the end result. When the courts stomped on plan gifts as violating the APR, § 363 sales became the best vehicle to achieve the end results without running afoul of the APR. The proposed amendment to § 1129 would obviate these end runs around the APR by creating a limited exception to the APR which recognizes that despite being property of the estate, plan distributions are functionally creditors' assets (and temporally become so after the effective date of a plan) which they should be free to gift as they see fit.

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272 *See supra* notes 53, 67 and accompanying text.

273 *See supra* notes 12, 14–15.

274 Bankruptcy Rule 9019 governs settlements. *See* FED. R. BANKR. P. 9019.

275 *See In re* W.T. Grant Co., 699 F.2d 599, 608 (2d Cir. 1983) (courts will approve settlements provided they are above the lowest point in the range of reasonableness).